NOS. 13 AND 15

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

THE BALTIMORE AND OHIO RAILROAD COMPANY, *et al., Appellants,*

v.

ABERDEEN AND ROCKFISH RAILROAD COMPANY, *et al., Appellees.*

INTERSTATE COMMERCE COMMISSION, *Appellant,*

v.

ABERDEEN AND ROCKFISH RAILROAD COMPANY, *et al., Appellees.*

On Appeal from the United States District Court for the Eastern District of Louisiana, New Orleans Division

BRIEF FOR SOUTHERN RAILROAD APPELLEES

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TABLE OF CONTENTS

torial average costs of all traffic carried by the Northern and Southern railroads; and (2) the costs of the North-South freight traffic, which constitute only 6 percent of the total freight traffic of the North and 21 percent of the total freight traffic of the South (A. 795-796). The Commission made it plain that its standard was the costs of the North-South freight traffic (325 I.C.C. at 50; A. 79-80):

> ". . . everything else being substantially equal, the relative costs of the parties *reflecting their respective operations as to this traffic* can properly serve here as a guide for the determination of just, reasonable and equitable divisions."
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> ". . . an adjustment in the divisions is required to compensate the respective groups according to their expenditures in the joint effort *of handling this interterritorial traffic.*" (emphasis supplied).

The Commission also stated that "the purpose is to measure the cost of services performed under the line-haul rates to be divided" (325 I.C.C. at 56; A. 89); and that the purpose is to "reflect the costs which are attributable to the traffic at issue" (325 I.C.C. at 26; A. 49-50). The Commission itself thus made it plain that, in using costs as a standard, the relevant costs are those associated with the North-South traffic which produces the revenues being divided. Use of average costs of all traffic, including primarily intraterritorial traffic, would inject revenue needs concepts foreign to the costs of service.

Under the Commission's own standard, the inflation which was accorded the North can be justified only by a showing of higher Northern costs in handling the North-South traffic in issue. The cost evidence relied upon by the Northern railroads was based upon the average costs of all traffic handled within the North and South, coupled with a "train

utilization study" purporting to show that North-South traffic and other traffic reflected in the territorial average were handled in the same trains in the North (A. 541-582). Analysis of the elements of the territorial average costs, however, revealed that for most items of rail freight service, including all of the costs of operating trains, maintaining roadway and stations, and the like, Northern costs are no higher than Southern costs, as measured by the averages relied upon by the Northern railroads. The entire difference between the Northern and Southern costs was accounted for by a relatively few factors (*e.g.*, border point interchanges, car costs, empty return ratios, switching at terminals, commuter deficits) (A. 864-865). The Northern railroads introduced no evidence showing that North-South traffic has characteristics substantially similar to territorial average traffic with respect to these cost elements.

With respect to each of the several elements of territorial average costs which account for the entire difference between Northern and Southern costs, the Southern railroads introduced evidence showing that the higher Northern territorial averages could not be related to the cost of handling North-South traffic. They also proposed adjustments to each such cost element. The Commission criticized and rejected these adjustments proposed by the Southern railroads and, instead, used unadjusted territorial average costs for each of the controverted cost elements that account for the difference between the Northern railroads. However, the Commission did not cite any evidence relating the higher Northern territorial average costs on these elements to the costs of the North-South freight traffic at issue. Nor did it make reasoned findings with respect to the specific contentions advanced by the Southern railroads on the basis of the evidence showing that territorial averages do not measure the relative costs of handling North-South traffic.

INDEX TO CITATIONS

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QUESTION PRESENTED

The Interstate Commerce Commission has ordered that the Northern railroads be given a disproportionate share of the uniform rates on North-South freight traffic. The exclusive basis for this order was that the Northern railroads incur higher costs than the Southern railroads in handling that particular traffic. However, the entire Northern inflation resulted from a few cost elements, as to each of which the Commission used the territorial average costs of all traffic in the respective territories. These averages were not adjusted to measure the relative costs

of the North-South freight traffic constituting only a small fraction of the total traffic. The question presented is whether, on a record in which the higher Northern territorial averages for the several cost elements accounting for the Northern inflation had been challenged as not reflecting the characteristics of the North-South traffic, the district court properly set aside the Commission's order on the ground that there was neither substantial evidence nor reasoned findings relating these higher Northern territorial averages to the North-South freight traffic at issue.

STATEMENT

Prior to the decision of the Commission, the revenues from freight traffic moving between the North and the South were divided on the basis of equality and uniformity. Divisions were made by use of an equal-factor divisional scale, which provided equal compensation for the same amount of service performed by either group of railroads. Thus, for shipments moving the same distance in each territory, the Northern and Southern railroads each received 50 percent of the joint revenue. *Official-Southern Divisions*, 287 I.C.C. 497, 547, 552 (1953).

The establishment of equal-factor divisions followed the Commission's historic decision in *Class Rates Investigation, 1939*, 262 I.C.C. 447 (1945), which was affirmed by this Court in *New York* v. *United States*, 331 U.S. 284 (1947), and which became fully effective in 1952, *Class Rates Investigation, 1939*, 281 I.C.C. 213 (1951). In the *Class Rates* case, the Commission determined that the higher rate levels at that time applicable to the movement of rail freight throughout Southern territory constituted an unlawful discrimination against the South and, accordingly, ordered the discriminatory rate structure replaced with a uniform rate structure applicable throughout the United States east of the Rocky Mountains. The prescrip-

tion of equal-factor divisions of joint rates followed the establishment of rate uniformity in the *Class Rates* case. *Official-Southern Division*, 287 I.C.C. 497, 523 (1953); see also *Official-Southwestern Divisions*, 287 I.C.C. 553, 578 (1953).

Proceedings Before the Commission

The present proceeding began when the Northern railroads filed a petition seeking, as they conceded, "*disproportionate* divisions of a uniform structure of rates" (A. 1543) (emphasis in original). The Commission's order accorded the Northern railroads disproportionate divisions by prescribing divisions calculated from divisional scales in which the scale for the North is substantially higher than the scale for the South. Thus, under the new divisions, for a shipment moving 300 miles in each territory, the Northern divisional factor is 241, whereas the Southern factor is 206 (325 I.C.C. at 51, 82; A. 81, 130), an inflation of 17 percent. The inflation becomes much greater (up to 45 percent) for shorter hauls and somewhat less for longer hauls (*ibid.*).

The inflation in the Northern railroads' divisions granted by the Commission was based exclusively on the Commission's conclusions with respect to cost of service. In considering the standards of Section 15(6) of the Interstate Commerce Act, the Commission found that the Northern and Southern railroads should be considered equally efficient (325 I.C.C. at 18; A. 39), that each group of railroads was of equal importance to the public (325 I.C.C. at 28; A. 51), and that neither group had greater revenue needs than the other (325 I.C.C. at 49; A. 79). Differences in costs were then expressly stated to be the exclusive basis of the Commission's decision (325 I.C.C. at 50; A. 79-80).

The Commission also stated explicitly what costs it relied upon as its standard, distinguishing between: (1) the terri-

Proceedings Before the District Court

The Southern railroads filed this action in the district court to set aside the portion of the Commission's order prescribing an inflation in the divisions of the Northern railroads (A. 6). The three-judge district court (Circuit Judge Wisdom and District Judges Hunter and West) set aside the Commission's order and remanded the case to the Commission. The basis of the district court's decision is summarized in the following portions of its opinion (A. 335, 349-350):

> "Only a relatively few elements of the Northern railroads' average costs are higher than the Southern railroads' costs. It is uncontroverted on this record that most elements of railroad costs (such as operating trains, maintaining roadways, etc.) are no higher in Northern railroads than for the Southern railroads. The inflation in the costs is attributable to a relatively few cost items. These include the cost of commuter operations, the cost of interchanging cars, the ratio of empty to loaded cars, the cost of railroad freight cars, and a few other items. As to each of these controverted items, the Commission relied exclusively on territorial average costs (Rail Form A)."
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> "The Commission stated its exclusive standard to be the relevant cost of handling the specific freight traffic to which the divisions apply. We are persuaded that the order is not based on substantial evidence nor supported by reasoned findings within the meaning of Sections 8(b) and 10(e) of the Administrative Procedure Act because the use of territorial averages accounting for the Northern inflation has not been supported with findings or evidence relating any such inflation to the North-South freight traffic.
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> "What is appropriate in one case may be inappropriate in another. We do not hold that the Commission was required to start from scratch and construct a new divisional scale directly from cost data. We do

find that, having stated its exclusive standard to be the relevant cost of handling the freight traffic to which the divisions apply, the Commission's order is not based on substantial evidence within the meaning of the Administrative Procedure Act. . . .

"With the Commission's expertise in mind, it is our duty to review the record and the conclusions reached, as required by the provisions of the Administrative Procedure Act. As to the sufficiency of the evidence to support the order, it is not the proper function of this Court to substitute its judgment or to weigh evidence. On the other hand, it is our duty to ascertain whether or not the findings and conclusions are supported by substantial evidence."

The district court also observed that compliance with the requirements of the Administrative Procedure Act was especially important in this case in which the outcome "is bound to cut deeply into economic relations on such a scale and when the result involves a departure from an equal divisions formula previously adopted" (A. 355).

The judgment of the district court has been appealed by the Northern railroads (B&O, et al.) and the Interstate Commerce Commission. The United States, the statutory defendant (28 U.S.C. § 2322), did not appeal.

SUMMARY OF ARGUMENT

I. In order to assure effective judicial review of administrative orders, Congress has provided that three-judge district courts shall have the power and the duty to set aside orders of the Interstate Commerce Commission found not to be supported by substantial evidence or reasoned findings. The court below, in performing that statutory duty, reviewed an order of the Commission which abandoned the uniform and equal basis upon which Northern and Southern railroads had been dividing the uniform

rates on North-South freight traffic and substituted divisional factors which are substantially higher for Northern railroads than for Southern railroads.

The exclusive standard adopted by the Commission in this case was the relative costs incurred by Northern and Southern railroads in handling North-South freight traffic at issue. For most elements of costs (including operating trains, maintaining roadway and stations and the like) the average costs were equal in the North and South. As a result, the entire inflation granted to the Northern railroads resulted from the Commission's treatment of a relatively few cost elements (including border interchanges, car costs, empty return ratios, switching and commuter deficits). With respect to each of these several elements that accounted for the entire Northern inflation, the Commission used the territorial average costs of all traffic in the North and in the South rather than the costs of the North-South freight traffic, which constitutes only a small fraction (6 percent) of all traffic in the North and only 21 percent of all traffic in the South.

The Commission's reliance on the higher territorial averages for the cost elements accounting for the entire inflation granted the Northern railroads was not supported by any evidence or reasoned findings relating that inflation to the North-South freight traffic. Since the Commission had adopted the costs of North-South traffic as its exclusive standard, the district court found that the Commission's order was not based upon substantial evidence or reasoned findings as required by Sections 10(e) and 8(b) of the Administrative Procedure Act.

Upon this record, reviewed in light of the standard adopted by the Commission itself, not only was the district court's decision within its power of judicial review but any other decision would have constituted an abdication of

the duty of judicial review established by Congress in the Administrative Procedure Act.

II. The correctness of the district court's holding that the inflation granted the Northern railroads was not supported by substantial evidence or reasoned findings relating any such difference in costs to North-South freight traffic is further shown by analysis of the several cost elements that account for the entire inflation.

The costs attributed by the Commission to the Northern railroads included deficits incurred in providing commuter service in Northern cities. The sole reason given by the Commission for including commuter deficits was that such deficits arise from costs common to freight and passenger service. But the Commission also found as a fact that "many individual items of suburban service" are not common costs at all but are, instead, "solely related" to suburban service (325 I.C.C. at 78; A. 124). The Commission did not justify imputing to the costs of North-South freight service the commuter deficits arising from costs which are solely related to commuter service and which thus have no relation to the costs of North-South freight service.

Appellants' efforts to justify the Commission's inclusion of the entire deficit from Northern commuter operations as an element of freight costs find no support in any finding of the Commission. Appellants' attempted justification rests on concepts of "revenue needs" which the Commission rejected as a basis for decision in this case, and upon a concept of consistency with rate-making—a concept which the Commission did not adopt but which, if adopted, would require uniform divisions of uniform rates rather than an inflation for the North. In recent cases and in reports to Congress, the Commission has articulated a policy *against* burdening freight shippers with deficits from commuter service, and favoring subsidy by the Northern communities

if such services are to be continued. The Commission unlawfully failed to supply any rationalization of its action here in imposing the burden of Northern commuter deficits on Southern railroads and shippers.

The Commission included a separate element in its prescribed cost scales to represent the costs incurred by Northern and Southern railroads in interchanging cars at territorial border points. Based upon territorial averages, this element shows costs 58 percent higher for the North than for the South. The Commission applied these territorial averages to North-South traffic, even though the Northern and Southern railroads are interchanging the *same* cars at the *same* border points and there is no evidence or finding justifying *any* higher costs for the Northern railroads than for the Southern railroads at these interchange points, much less 58 percent higher costs.

Although North-South freight traffic moves in the same cars between the North and the South, the Commission used territorial average car costs which are 32 percent higher for the North. There is no evidence to support any higher costs for the North with respect to the cars used jointly in handling North-South traffic, and the underlying findings of the Commission do not support, but in fact impeach, the prescription of any inflation. Moreover, because the difference in the territorial average costs results from differences in the railroads' car-owning and leasing activities, as contrasted with their function as transportation agencies, the Commission's use of such average costs also violates Section 15(6) of the Interstate Commerce Act, under which the only relevant costs are those incurred in "the service of transportation."

The Commission used the average terminal switching costs for all traffic in each territory in the absence of any evidence relating the higher Northern territorial average costs for all traffic to the relative costs of Northern and

Southern railroads in switching the cars carrying North-South traffic. The Commission rejected the Southern railroads' switching studies as having the "major defect" of being applicable only to the Southern costs of switching North-South traffic and not showing comparable figures for the North (which the Northern railroads declined to study). As the courts have previously held, such treatment of switching costs is untenable.

The Commission applied territorial average empty return ratios to North-South traffic without any evidence that the higher Northern averages were applicable to North-South traffic. And it did so in the face of evidence of record showing that the higher Northern territorial average resulted from traffic characteristics within that territory that had no bearing upon the empty return ratios incurred with respect to North-South traffic. Also, the Commission's use of admittedly inconsistent methods in counting cars improperly inflated the Northern costs. Furthermore, the Commission rejected an adjustment to reflect the full Southern costs of handling essentially transit commodities in North-South traffic on the ground that no comparable adjustment was made for the Northern costs, despite the concession of the Northern railroads that no comparable situation existed in the North.

III. The Commission's departure from its long-standing policy of relating divisions to rate structures, a policy which resulted in uniform divsions of uniform rates in the North and South, has not been justified. Even if the costs applied by the Commission to North-South traffic had been supported by evidence, no reason was given for using the inflation in the Northern costs as a basis for inflating the Northern share of the entire revenue from North-South traffic, which produces a substantial profit over and above the costs incurred in handling that traffic.

IV. There is no merit to the argument made by the Northern railroads that the district court erred in setting aside the Commission's order without reserving jurisdiction where, as here, the Northern railroads did not ask that court to reserve jurisdiction, the procedure followed was in accordance with the express stipulation of the Northern railroads, and re-establishment of uniform divisions is not inequitable to the Northern railroads, which have failed to prove any higher costs in the handling of North-South traffic.

ARGUMENT

I. THE DISTRICT COURT PROPERLY SET ASIDE THE COMMISSION'S ORDER GRANTING AN INFLATION IN THE NORTHERN RAILROADS' DIVISIONS WHERE THAT INFLATION WAS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE OR REASONED FINDINGS.

The action of the Commission challenged in this case is the abandonment of equal and uniform divisions related to the uniform rate structure and the substitution of a new basis under which the divisional scale for the North is substantially higher than the divisional scale for the South.

Although this action of the Commission was expressly based upon its conclusion that the Northern railroads' costs of handling North-South traffic are higher than those of the Southern railroads with respect to a relatively few elements of service, appellants do not attempt to justify the inflation granted to the North by supporting the few specific cost determinations upon which it rests. They prefer, instead, to discuss generally the Commission's undenied discretion and expertise in finding costs and prescribing divisions. But this case does not turn on any such generalities. The specific question presented by this case and decided by the district court is whether the inflation accorded the Northern railroads is supported by substantial evidence and reasoned findings as required by statute.

In Section 10 of the Administrative Procedure Act, Congress provided for effective judicial review of administrative action. Section 10(e) provides: "The reviewing court shall . . . hold unlawful and set aside agency action, findings and conclusions found to be . . . unsupported by substantial evidence" (5 U.S.C. § 706). Congress further provided that all agency decisions "shall include a statement of . . . findings and conclusions, and the reasons or basis therefor, on all material issues of fact, law, or discretion presented on the record" (5 U.S.C. § 557(c)).

Thus, under the statute, it was the duty of the district court to determine whether the Commission's order granting an inflation to the Northern railroads contained reasoned findings which were supported by substantial evidence. *Universal Camera Corp.* v. *N.L.R.B.*, 340 U.S. 474, 487-488 (1951). The district court held that, where the Commission had prescribed divisions "on the basis of the average cost of all traffic for this series of important elements of cost which are higher in the North for reasons that have not been shown to have any relation to the North-South freight traffic here at issue," the Commission's "order is not based on substantial evidence nor supported by reasoned findings within the meaning of Sections 8(b) and 10(e) of the Administrative Procedure Act" (A. 348-349).

The record before the district court compelled this conclusion. The basic issue in the case was whether inflated divisions for the Northern railroads were justified on the basis of relative costs. Both Northern and Southern railroads used the Rail Form A cost formula as a framework for analysis. Of the scores of separate cost elements covered by Rail Form A, the Northern railroads' claim for an inflation depended upon the use of the unadjusted territorial average costs of all traffic for a few elements. Analysis of these several elements did not involve any attack upon Rail Form A as a framework for cost analysis, and the

Commission itself did not reject the Southern railroads' claims on any such basis. Instead, the controversy as to each of the challenged cost elements centered on the question of whether the difference in the territorial averages represented higher Northern costs incurred in handling North-South traffic.

The Southern railroads presented evidence to show that the higher Northern territorial average costs could not be used to justify an inflation with respect to the North-South traffic at issue in this case in light of the physical facts of handling North-South traffic. For example, as more fully described *infra* (pp. 43-46), the Southern railroads showed that North-South traffic moves between the territories in the same cars, and that these cars are interchanged between Northern and Southern railroads at points located on the territorial border under such circumstances that these costs, whatever their dollar amount, are the same for both Northern and Southern railroads. No Northern railroad witness even claimed that these costs were higher for the Northern railroads. Yet the Northern railroads relied upon and the Commission used territorial average interchange costs which are 58 percent higher in the North. Although critical of the Southern railroads' efforts to estimate the dollar amount of the equal costs of interchanging the same cars at the same points, the Commission did not find that the Northern costs for this element of service are in fact higher than Southern costs, but simply used the 58 percent higher territorial average. An unexplained and unjustified reliance upon the territorial average costs for all traffic cannot serve as evidence when the whole issue is whether any difference in the costs, much less the 58 percent difference in the territorial averages, is applicable to North-South traffic.

The Northern railroads did not present evidence even attempting to show how the higher average costs of all traffic could have any relation to the North-South traffic at issue insofar as the elements which accounted for the entire Northern inflation were concerned. The Northern railroads did introduce a "train utilization study" designed to show that North-South traffic moves in the same trains as other traffic (ICC Brief, p. 35 n. 31; B&O Brief, pp. 32, 38). But there is no controversy as to train costs, such as "locomotive maintenance, fuel, train crew costs" (ICC Brief, p. 27), because average train costs are not higher in the North than in the South (A. 864-865). As a result, these costs had nothing to do with the cost elements upon which the inflation prescribed by the Commission rested (as the district court recognized, A. 335). Analysis of train costs merely confirms that the costs of handling North-South traffic are equal in the respective territories.

Appellants' present theory that the "train utilization study" supports the use of territorial averages to measure *all* elements of cost on North-South freight traffic finds no support in the record and is contradicted by the Commission's own decision since, as counsel concede (ICC Brief, p. 8), the Commission itself adjusted the territorial averages in several separate respects. Nowhere did the Commission itself rely upon generalizations about train costs or the "train utilization study" as justifying use of unadjusted territorial averages to measure the several elements, including gateway interchanges, car costs, empty return ratios, and commuter deficits, which actually account for the inflation granted the Northern railroads but which have nothing whatever to do with "train utilization".[1]

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[1] In citing the conclusions of the Northern railroads' witness who introduced the "train utilization study" (ICC Brief, p. 35), Commission counsel fail to indicate that this same witness confined

As to these disputed cost elements, the Northern railroads simply rested upon the territorial averages themselves. Thus, unlike the usual case in which the Commission decides on the basis of conflicting evidence whether or not the territorial average properly measures the cost of a particular service performed on the traffic involved, the record here was devoid of evidence justifying the application of higher Northern territorial average costs to North-South traffic with respect to the cost elements that accounted for the entire Northern inflation. Upon such a record, the district court properly concluded that the Northern inflation prescribed by the Commission was not supported by substantial evidence or reasoned findings.

Such a holding does not, as appellants would have this Court believe, condemn Rail Form A or render it unwork-

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his conclusion to train operations and admitted that he knew nothing about empty return ratios or the other cost elements that cause the inflation in the Northern costs (A. 986).

The Northern railroads refer to Northern wage levels, which they say are higher than those in the South (B&O Brief, p. 39, n. 14). The cost of labor was not one of the elements of Rail Form A costs relied upon by the Commission to show a generally higher Northern cost level. Nor could the Commission have relied upon labor costs because wages in the North, which are only 2 per cent higher than in the South and which occur in the "executive and professional" categories (A. 941, 1035-1036), are offset by the far greater traffic density on the lines of the Northern railroads than is enjoyed on the lines of the railroads operating in the South (A. 791). Whatever the factors affecting the levels of these costs in the several territories, their net effect is that the costs *per unit* of traffic are not higher in the North except for the several elements of territorial average costs referred to in the text that account for the entire Northern inflation.

able. All that the district court required, and the least that it could have required, was that with respect to the several cost elements which produced the entire Northern inflation, there be evidence relating the difference in the territorial average costs to the North-South traffic at issue (A. 348-349):

> "Defendants argue that the question of whether or not Rail Form A was representative, and whether it should have been supplemented are questions of fact, the determination of which is within the competence of the Commission. We start, of course, from the premise that on the subject of transport economics, the Commission's judgment is entitled to great weight. The appraisal of cost figures is itself a task for experts and, unlike a problem in mathematics, it cannot be precisely right or wrong. We know, too, that the Rail Form A cost formula was devised for the express purpose of measuring territorial average costs and has been widely used as an acceptable means of comparing relative transportation costs. It represents a comprehensive study entitled to full weight when the issue is one that it was designed to cover. However, this formula was designed to measure the cost of handling all the traffic in two or more territories, and cannot appropriately be accepted *without further evidence* for mechanical application to particular segments of traffic in a divisions case. The 'many minute calculations' contained in Rail Form A were used to measure the overall average costs and certainly produce a misleading appearance of exactitude when applied mechanically to measure a specific cost of a specific body of traffic such as that involved here. Evidence of overall territorial averages surely can and should be considered, *but as to specific important cost items the Commission should not wholly and exclusively rely on such averages. United States* v. *Abilene and Southern R.R. Co.*, 265 U.S. 274; *Atchison, Topeka and Santa*

Fe Ry. Co. v. *United States*, 225 F. Supp. 584." (Emphasis supplied).[2]

It is thus apparent that the district court did not hold or even suggest that the Commission should not follow the Rail Form A method of analyzing transportation costs by breaking down transportation services into the particular elements of cost. What the district court did hold was that in using this method of cost determination, the Commission could not simply assume, without evidence, that a higher Northern territorial average for a particular element of cost necessarily meant that the Northern railroads incurred similarly higher costs on North-South traffic.

It is simply arbitrary to assume, without any supporting evidence, and in the face of the undisputed physical facts, that the average costs of 100 percent of the Northern traffic and 100 percent of the Southern traffic measure, as to all elements of cost, the relative costs of handling North-South traffic, which represents only 6 percent of the total traffic in the North and 21 percent of the total traffic in the South (A. 795-796). The average costs of the Northern railroads are obviously governed by the costs of the 94 percent of the total traffic which is not North-South traffic. Indeed, nearly 80 percent of the total Northern traffic is intraterritorial (A. 908), and it is that traffic, handled entirely within the North, that has the dominant

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[2] In *United States* v. *Abilene and Southern R. Co.*, 265 U.S. 274, 291 (1924), Mr. Justice Brandeis emphasized in a divisions case that "averages are apt to be misleading." In *Atchison, T. & S. F. Ry. Co.* v. *United States*, 225 F.Supp. 584, 606-607 (D. Colo. 1964), the three-judge court (opinion by Judge Doyle) set aside a Commission order prescribing divisions where the Commission had relied upon misleading averages without the reasoned findings required by the Administrative Procedure Act. Neither the Commission nor the United States appealed that decision.

influence on the Northern average. A higher Northern average cost may well mean that the cost of handling intraterritorial traffic is higher than the cost of handling the *different* intraterritorial traffic in the South. But it is arbitrary to assume, without further evidence, that territorial averages alone prove that the Northern costs are higher than the costs of the Southern railroads in their joint handling of the *same* traffic between the North and the South.[3] As the Court held in setting aside an order of the Commission in *I.C.C.* v. *Mechling*, 330 U.S. 567, 583 (1947): "The unsifted averages put forward by the Commission do not measure the allegedly greater costs [of the carriers] nor indeed show they exist."

The ruling of the district court that the several territorial average cost elements which account for the entire Northern inflation could not be sustained without any evidence relating the differences in the territorial average cost to North-South traffic is the minimum ruling that the court could have made consistent with the statutory requirement that Commission orders be supported by substantial evidence. Contrary to the contentions of Commission counsel that the district court ruling will somehow frustrate the Commission's administration of divisions and rate cases (ICC Brief, p. 33, n. 27), the Commission itself has imposed a far more rigorous and all-inclusive standard. In *Increased Freight Rates, 1967*, 332 I.C.C. 280 (1968), the Commission held on three separate occasions that territorial average costs have little value in determining the costs of handling particular segments of traffic. For example, the Commission held: "Territorial costs are not necessarily

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[3] The question is not whether any averages may be used. Rather the question is whether the relative costs of handling two bodies of traffic (all traffic in each of the two territories) may be used, without any supporting evidence, to measure the relative costs of handling a single and different body of traffic (North-South traffic).

determinative of the costs of particular movements. See *Louisville & N. R. Co.* v. *Akron, C. & Y. R. Co.*, 309 I.C.C. 491 [a divisions case involving one Southern railroad and all Northern railroads]" (332 I.C.C. at 294). The Commission also ruled that "territorial average costs are entitled to little weight in determining the costs of handling particular movements" (332 I.C.C. at 303; see also 332 I.C.C. at 296).

No one has ever suggested that these holdings, or similar holdings of the Commission in divisions cases[4] and rate cases,[5] cast any doubt upon the usefulness of Rail

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[4] *Louisville & N.R. Co.* v. *Akron, Canton & Youngstown R. Co.*, 309 I.C.C. 491, 509 (1960); affirmed sub nom. *Boston and Maine R. Co.* v. *United States*, 208 F. Supp. 661 (D. Mass. 1962), affirmed 371 U.S. 26 (1962); *Louisville & N.R. Co.* v. *Southern Ry. Co.*, 319 I.C.C. 639, 654 (1963), affirmed sub nom. *Carolina & Northwestern Ry. Co.* v. *United States*, 234 F.Supp. 112 (W.D. N.C. 1964), affirmed, 380 U.S. 526 (1965). In *Illinois Central R. Co.* v. *Great Northern Ry. Co.*, I.C.C. Docket No. 34699 (Examiner's report dated September 15, 1966, adopted by the Commission July 31, 1967, modified March 20, 1968), the Commission relied upon a cost study in which, contrary to the contention of the Northern railroads (B&O Brief, p. 33, n. 10), the Illinois Central had adjusted Rail Form A "to take into account the particular characteristics of the traffic involved" including switching costs, interchange costs and other elements (Examiner's report, sheet 4). None of the several cost elements which account for the entire Northern inflation in this case was specifically controverted in the *Illinois Central* case.

[5] *Midwest Emery Freight System, Inc.* v. *Baltimore & O. R. Co.*, 321 I.C.C. 637, 650 (1964); *American Agricultural Chemical Co.* v. *Atlantic C. L. R. Co.*, 258 I.C.C. 779, 786 (1944); *United States* v. *Great Northern Ry. Co.*, 293 I.C.C. 341, 345 (1954); *State Corporation Commission of Kansas* v. *Atchison, T. & S. F. Ry. Co.*, 301 I.C.C. 703, 742 (1957); *Rochester & Pittsburgh Coal Co.* v. *Baltimore & O. R. Co.*, 294 I.C.C. 423, 433-435 (1955); *Rath Packing Co.* v. *Ahnapee & W. Ry. Co.*, 296 I.C.C. 693, 715 (1955); *Phosphate Rock to Shreveport and Nacogdoches*, 298 I.C.C. 353, 358-359 (1956); *Crude Sulphur from Louisiana and Texas to Virginia*, 300 I.C.C. 715, 726 (1957).

Form A as a tool for cost determination.[6] The Commission simply held in those cases, as the district court held here with respect to the several cost elements that account for the entire Northern inflation, that unadjusted territorial averages should not be used without independent evidence to support their application to the particular traffic at issue.[7]

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[6] Nor has the Commission itself ever suggested, as appellants strenuously urge here (ICC Brief, p. 26, B&O Brief, p. 34), that the requirement of anything more precise than territorial average costs is illusory, and that more reliable costs are impossible of ascertainment. If more reliable costs can be determined in rate cases for large categories of traffic moving throughout the various territories with a degree of accuracy sufficient to lead the Commission to reject territorial averages as entitled to little weight, the same improvement in reliability can be achieved with any other body of traffic, including North-South traffic.

[7] Appellants' reliance on the use of Rail Form A in *New York* v. *United States*, 331 U.S. 284 (1947) (ICC Brief, p. 35, n. 30; B&O Brief, pp. 31-32), is misplaced. In that case, the Commission made it plain that "the intent of the cost study was to reflect territorial average operating conditions . . ." *Class Rates Investigation, 1939*, 262 I.C.C. 447, 588 (1945). The Commission was not, as appellants assert, undertaking to measure the cost of the small volume of traffic actually moving on class rates, but was deliberately seeking to measure the average costs of all traffic. Class rates constitute a maximum or ceiling for all traffic, and the Commission has consistently used the class rates prescribed in that proceeding as the guide for rates generally. See *Page Belting Co.* v. *Boston & M. R. Co.*, 294 I.C.C. 307, 309 (1955); *Mannington Mills, Inc.* v. *Abilene & S. Ry. Co.*, 301 I.C.C. 275, 276, 283 (1957), and cases cited therein. In *New York* v. *United States*, 331 U.S. 284 (1947), the Court upheld the Commission's action on the premise that it was intended to affect all traffic (331 U.S. at 309). The Commission's deliberate use of territorial averages applied to all traffic in the *Class Rates* case is in marked contrast to the Commission's declaration in this case that the standard here is the cost of handling the North-South traffic in issue (325 I.C.C. at 26, 50, 56; A. 49-50, 79-80, 89).

Appellants also argue that the district court imposed an undue burden upon the Commission when it pointed out that the Commission has extensive powers to require the production of cost evidence (ICC Brief, pp. 31-33; B&O Brief, pp. 34-39). The district court did not impose any burden on the Commission, much less an undue burden. The holding of the district court was simply that the Commission itself having stated as its exclusive standard the costs of North-South traffic, the Commission's action in prescribing an inflation for the North was not supported by substantial evidence or reasoned findings relating any such inflation to the North-South traffic (A. 349).

The question of the extent of the Commission's power "to investigate and gather evidence beyond that presented" (A. 353) was raised by the Commission's rejection of several of the adjustments proposed by the Southern railroads on the ground that, although the Southern railroads had presented evidence showing the costs of handling North-South traffic in the South, the Northern railroads had not presented evidence of the costs of handling North-South traffic in the North and, therefore, no "comparable evidence was available in the record" (district court opinion, A. 344 n. 13, citing four such instances in the Commission's report, 325 I.C.C. at 60, 66, 69, 76; A. 94, 105, 110, 121). Under these circumstances the district court properly observed: "The I.C.C. is not the prisoner of the parties' submissions. It is empowered to investigate and gather evidence beyond that presented . . ." (A. 353). The district court added that, in a case in which there is a lack of substantial evidence to support the Commission's order, so that additional cost evidence "is necessary to assure an adequate record," the Commission has a duty before it acts "to take affirmative action to require the development of an adequate record" (A. 354).

In referring to the Commission's powers to obtain evidence, the district court was simply emphasizing its holding that an order prescribing an inflation for the Northern railroads based upon the costs of handling North-South traffic must be supported by substantial evidence. Whether the Northern railroads supply the evidence,[8] or the Commission itself gathers the evidence, there must be substantial evidence to support the prescribed Northern inflation before the Commission's order can be sustained (see A. 1279-1290). The district court held that, because the evidence to support the inflation had not been obtained by *any* means, the inflation was unsupported by substantial evidence.[9]

Appellants would obscure the question presented by this case and decided by the district court. For example, Commission counsel state (ICC Brief, p. 3):

> "The question presented is whether, in ascertaining the relative costs of service in an interterritorial divi-

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[8] As the Court stated in *Interstate Commerce Commission* v. *New York, N.H. & H.R. Co.*, 372 U.S. 744, 760, n. 12 (1963):

> "Of course, when such an issue is raised, each carrier should bring forward the data relating to its own costs that are required for resolution of the issue."

[9] In *Boston & Maine R. Co.* v. *United States*, 162 F. Supp. 289, 298 (D. Mass. 1958), the district court set aside a Commission order and held that if the cost evidence is not sufficient, the Commission has the duty to take further evidence or "turn the matter over to its accounting staff for investigation." On appeal by other parties, the Commission declined to defend its order and advised this Court of its readiness to "'proceed in accordance with the terms of the remand". *Boston & Maine R. Co.* v. *United States*, 358 U.S. 68, 71 (1958). See also *Eastern Central Motor Carriers Ass'n* v. *United States*, 239 F. Supp. 591, 599, 601 (D. D.C. 1965); *Pacific Inland Tariff Bureau* v. *United States*, 129 F. Supp. 472, 486 (D. Ore. 1955). The Commission did not appeal either of these holdings as imposing any undue burden upon its administration of the Act.

> sions case, the Commission may rely on Rail Form A data as to territorial average costs, *adjusted* to more accurately reflect the costs of the particular traffic involved, or is required to develop more refined cost data." (Emphasis supplied).

This statement of the question ignores the dominant feature of this case, namely, that the Commission ordered a change from uniform divisions of uniform rates to a substantial inflation in the divisions of the Northern railroads, and that with respect to the few specific elements of cost which account for the entire Northern inflation, the Commission used territorial average costs *without any adjustment* and without evidence relating the higher Northern territorial average costs to the North-South traffic.

Appellants do not dispute the district court's statement that "the entire inflation is pegged on relative costs derived from Rail Form A" (A. 350). But counsel nevertheless present arguments that have no bearing upon the issues presented by this case. For example, Commission counsel urge: "The Commission plainly has the statutory authority to compute costs by adjusting and applying Rail Form A territorial unit data [to North-South traffic]" (ICC Brief, p. 17). No one, least of all the district court, challenges the statutory authority of the Commission "to compute costs by *adjusting* and applying Rail Form A" (emphasis supplied). The issue in this case arises from the fact that the entire inflation accorded the Northern railroads is produced by the Commission's use of Rail Form A territorial average costs for several specific cost elements as to which the Commission made *no adjustment at all,* and as to which there was no evidence relating the higher Northern average costs of all traffic to the North-South traffic, which

constitutes only 6 percent of all traffic in the North and 21 percent of all traffic in the South (A. 795-796).[10]

Appellants also obscure the issue by arguing that the district court has interfered with the administration of the Interstate Commerce Act by *requiring* the Commission to decide divisions cases on the basis of the costs of handling the specific traffic at issue (ICC Brief, pp. 3, 11, 12, 16; B&O Brief, pp. 5, 16, 18, 29, 33-34, 37). But the district court did not decide that these divisions should be based on the relative costs of North-South freight traffic. That was the Commission's decision.[11] As the district court stated: "The Commission stated its exclusive standard to be the relevant cost of handling the specific freight traffic to which the divisions apply" (A. 349). The district court

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[10] *Carolina & N.W. Ry.* v. *United States*, 234 F. Supp. 112 (W.D.N.C. 1964), affirmed, 380 U.S. 526 (1965), cited by Commission counsel for the proposition that this Court has approved "restated Rail Form A computations" (ICC Brief, pp. 18-19), has no bearing on the issue where, as here, the entire inflation is produced by several territorial average cost elements which were not "restated" by the Commission. In the case cited, the district court upheld the Commission's action in *making* an adjustment in the critical element of car costs to reflect the costs of the traffic at issue, dismissing a complaint that the Commission should not have "deviated," as it did (319 I.C.C. at 654), from the unadjusted Rail Form A average cost.

[11] This is not a case in which the district court has attempted to impose upon the Commission its own views with respect to the economics or any other feature of the standard selected by the Commission. Compare *American Commercial Lines, Inc.* v. *Louisville & N. R. Co.*, — U.S. — (decided June 17, 1968), where the district court had disagreed with the cost standard adopted by the Commission in passing upon rail rates reduced in competition with barge rates.

properly and necessarily[12] examined the record to ascertain whether there was substantial evidence to support the Northern inflation under the standard which the Commission itself had adopted. The Commission having selected as its exclusive standard the costs of handling North-South traffic, the question for judicial review was whether the inflation accorded the Northern railroads was supported by substantial evidence and reasoned findings relating that inflation to the costs of the North-South traffic at issue.[13]

As Commission counsel recognize, Rail Form A breaks down the total expenses of the carriers into a number of groups or elements, such as train crew costs, locomotive maintenance, car costs, and many others; and each element is subject to adjustment as required by the facts of a particular case (ICC Brief, p. 18, n. 13). In this case, the use of territorial average costs for a relatively few elements accounts for the *entire* inflation accorded to the Northern railroads (A. 864-865). The district court expressly recognized this significant feature of the case (A.

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[12] "A reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency." *S.E.C.* v. *Chenery Corp.*, 332 U.S. 194, 196 (1947); *Burlington Truck Lines* v. *United States*, 371 U.S. 156, 168-169 (1962); *N.L.R.B.* v. *Metropolitan Life Ins. Co.*, 380 U.S. 438, 443-444 (1965).

[13] For this reason, Commission counsel's reliance upon *S.E.C.* v. *New England Electric System*, 390 U.S. 207 (1968) (ICC Brief, pp. 14, 23, 26), is misplaced. In that case, the lower court was reversed for an "unwarranted incursion into the administrative domain" where that court had disagreed with the agency on the basis of its own "fresh review of all the evidence" (390 U.S. at 211-212). This Court observed the statutory standard that administrative findings were conclusive "if supported by substantial evidence" (390 U.S. at 211). The district court in the present case has observed the same standard.

335) and directed its attention to the particular question of whether there was substantial evidence to support "the use of territorial averages accounting for the Northern inflation" in measuring the relative costs of North-South traffic (A. 349).

The district court found no substantial evidence or reasoned findings "relating any such inflation to the North-South freight traffic" (A. 349). Contrary to the overdrawn assertions of Commission counsel (ICC Brief, p. 22, n. 19), the district court did not require "slavish adherence to any particular exactitude." It did require that there be substantial evidence relating the prescribed inflation to the North-South traffic. Appellants make no effort to cite any evidence that even purports to show that the several territorial average cost elements which produce the entire inflation have any relation to the comparative costs incurred in handling the North-South freight traffic. Instead, appellants devote their discussions of the specific cost elements that produce the inflation to an attack on estimates made by the Southern railroads to adjust these costs (ICC Brief, pp. 38-48; B&O Brief, pp. 40-42). But even assuming for the purpose of judicial review that the adjustments suggested by the Southern railroads were properly rejected by the Commission, the use of the unadjusted territorial averages that produce the entire inflation remains unsupported by evidence relating such an inflation to the North-South traffic.

Contrary to appellants' repeated assertions to the contrary (ICC Brief, pp. 18, 20, 25; B&O Brief, pp. 19, 26-30), the decision of the court below is not inconsistent with the decision in *Chicago & N.W.R. Co.* v. *Atchison, T. & S. F. R. Co.*, 387 U.S. 326 (1967). In that case, a district court had set aside a Commission order on the ground that it failed to make findings as to the revenue needs of individual railroads. The United States and the Commission

appealed in order to defend the group basis of determining divisions. This Court held that the district court had erred (387 U.S. at 340-351), and went on to uphold the Commission's cost findings as well (387 U.S. at 356). The Court pointed out that the parties *attacking* the order (the Mountain-Pacific railroads) were the *beneficiaries* of an inflation in their divisions.[14] The Court reviewed the Commission's cost findings and upheld Commission's decision "to base its cost findings upon the special cost study and analysis prepared by the Mountain Pacific carriers," subject to "certain adjustments to the Mountain-Pacific analysis which, in the judgment of the Commission, more accurately reflected the true costs of the traffic involved" (387 U.S. at 352).[15]

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[14] The inflation granted by the Commission was expressly related to the different and higher level of rates west of the Rocky Mountains (387 U.S. at 357-358).

[15] The Northern railroads contend that the Commission's treatment of two of the seven cost elements that account for the entire Northern inflation in this case (car costs and empty return ratios) "was sustained by this Court" in the *C&NW* case (B&O Brief, p. 42, n. 16, 17).

With respect to car costs, the Court expressly stated in *C&NW* that it did *not* review the Commission's treatment of that cost element because "this issue related only to the Eastern divisions," which, as the Court emphasized, were "no longer in issue" (387 U.S. at 354).

With respect to empty return ratios, the Court sustained the Commission's treatment, quoting from the Commission's report in that case which showed that "[m]any special studies of empty-return movement were undertaken in these proceedings" (387 U.S. 352). One of these special studies, presented by the Midwestern railroads, was designed to show that the territorial average empty return ratios did, in fact, reflect the empty-return relationship applicable to the traffic at issue (I.C.C. Docket 31503, Exhibit MW-586, pp. 42-44). Thus, the record in that case did contain evidence relating the territorial average costs to the traffic in issue. No such evidence exists in the present case. Indeed, the Northern railroads expressly refused to make a study on this subject (see p. 60, n. 35, *infra*).

Appellants' arguments, including their mistaken reliance upon the *C&NW* case, all come down to the proposition that Commission orders relating to divisions or costs are simply beyond the scope of any effective judicial review (*e.g.*, ICC Brief, p. 19; B&O Brief, pp. 25-26).[16] This is not the law. Congress has empowered and directed the federal courts to provide effective judicial review and has specifically directed that administrative orders be set aside by the courts where not supported by substantial evidence or reasoned findings. Administrative Procedure Act, Sections 8(b) and 10(e).[17] This Court has emphasized that these provisions are meant to be enforced. *Burlington Truck Lines* v. *United States*, 371 U.S. 156, 167-168 (1962).

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[16] The Northern railroads rely heavily on the pre-Administrative Procedure Act decision in *Illinois Commerce Commission* v. *United States*, 292 U.S. 474 (1934) (B&O Brief, pp. 25, 39, 43; also ICC Brief, p. 19), although that case had nothing whatsoever to do with the requirements of adequate findings or substantial evidence. It involved a Commission order directing "the removal of unjust discrimination against interstate commerce, resulting from disparity of the intrastate and interstate switching rates of interstate rail carriers in the Chicago Switching District" based on a specific cost study of switching movements in Chicago (292 U.S. at 476). That case would be analogous to the present case only if the cost study relied upon to measure Chicago switching costs had been developed from the average cost of all switching movements throughout the entire North.

[17] As Judge Prettyman held in reviewing a cost determination by another agency in *Mississippi River Fuel Corp.* v. *F.P.C.*, 163 F.2d 433, 439 (D.C. Cir. 1947):

> "The discretion which must be exercised is that of the Commission. Congress has confided that function to it. At the same time, Congress has forbidden arbitrary action and has imposed upon the courts a duty of review in that respect. Arbitrary action, if it means anything, means action not based on facts or reason. The discretion and judgment confided in the Commission must be exercised upon facts and for reason. The duty of review imposed upon the courts requires that the

The district court in the present case has performed its statutory duty of determining whether the inflation granted the Northern railroads was based upon substantial evidence and reasoned findings with respect to the cost of North-South traffic—the standard adopted by the Commission itself. Since appellants are unable to refer this Court to any evidence of record relating the territorial averages of all traffic to the costs of North-South traffic with respect to the several elements of cost which account for the entire inflation, it is manifest that the district court was correct in its holding.

II. REVIEW OF THE COMMISSION'S TREATMENT OF EACH OF THE SPECIFIC ITEMS ACCOUNTING FOR THE NORTHERN INFLATION REVEALS A LACK OF SUPPORT IN SUBSTANTIAL EVIDENCE AND REASONED FINDINGS.

As has been shown, the district court was correct in setting aside the Commission's order because of the lack of substantial evidence and reasoned findings relating the higher territorial average costs for the several cost items that accounted for the entire Northern inflation to the costs of handling the North-South traffic here in issue. The correctness of this holding is further demonstrated by analysis of each of the specific cost items in controversy.

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facts be found and the reasons stated. Otherwise, the courts cannot determine whether a given action is or is not arbitrary.

"The Congressional provisions extend to complicated, difficult matters as well as to simple questions. The courts cannot evade their responsibility merely because the subject matter is obscure. And neither can they be required to probe the minds of the agency for unfound facts or unexpressed reasons. The coordination of the two functions of administrative discretion and judicial review requires that the facts upon which the discretion is exercised, and the reasons, be clearly and completely stated. When the matter is complicated, the necessity is greater."

A. The Commission's Inclusion of Commuter Deficits in the Northern Railroads' Costs is Wholly Unjustified.

One of the important reasons why the Northern railroads' territorial average costs are higher than the average costs of the Southern railroads is that the Northern railroads' average costs are increased by the inclusion of suburban passenger deficits, whereas the Southern railroads do not have any substantial commuter operations.

The underlying facts are not in dispute. Through the use of average costs, the deficits attributable to both intercity passenger service and suburban commuter service are included in the cost computations for the Northern and Southern railroads. It is generally agreed that the intercity passenger deficits must be considered as part of the costs of providing freight service, for such deficits are usually the result of costs allocated to passenger operations from common facilities which must be maintained in order to provide freight service (A. 713-714).[18] Suburban passenger deficits, however, are quite another matter. The railroads which carry large numbers of people from their homes in the suburbs to their places of work in the cities often, if not exclusively, use separately constructed and maintained lines. These suburban commuter operations require facilities with no other use whatever.

At no time during the proceedings before the Commission did the Northern railroads even try to offer any sup-

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[18] The necessity of maintaining common facilities for freight service was recognized by the Court in *King* v. *United States*, 344 U.S. 254, 265 (1952):

> "In Florida, moreover, the discontinuance of railroad passenger service would not permit the discontinuance of high-speed tracks and equipment because of the need for fast freight schedules to transport perishable fruits and vegetables from Florida."

port for treating all commuter deficits as a part of the cost of freight service. Indeed, the position of the Northern railroads at that time emphasized the solely-related character of commuter service (Statement of Northern commuter railroads quoted at A. 714-715):

> "Another vitally important feature of railroad suburban service is the subject of wide misunderstanding by the public. This is the extent of railroad investment and railroad costs represented by fixed facilities, such as track. It is a widely held but entirely false belief that railroads use, for their suburban and commutation services, primarily those roadway facilities which they must necessarily have and maintain for their other operations. . . .
>
> "These notions are completely false as applied to railroads handling a substantial volume of suburban passengers. Reference to Exhibit J [a chart showing exclusive use of tracks for suburban service] exemplifies the situation which actually exists. . . .
>
> ". . . one-half of the track facilities in this territory are maintained solely because of the company's suburban service operations. A far larger proportion of other roadway facilities, such as stations, terminals, coach yards and repair shops, are maintained solely in connection with suburban service."

The sole reason given by the Commission for the inclusion of commuter deficits in Northern railroad costs is that "*Because* the suburban service deficit *includes common costs* which must be incurred to provide freight service or intercity passenger services, *such* costs are properly chargeable to those services to the extent they cannot be recovered from suburban operations" (325 I.C.C. at 78; A. 124) (emphasis supplied). This finding of the Commission justifies inclusion of suburban deficits to the extent, and only to the extent, that they relate to common costs.

But the Commission also found as a fact that "*many* individual items of suburban service can be considered *solely related* . . . to suburban service" (325 I.C.C. at 78; A. 124) (emphasis supplied). This finding was required by the uncontroverted evidence of record showing that commuter equipment, and many tracks, yards, stations and other facilities are solely related to commuter service and thus have nothing whatever to do with the cost of handling North-South or any other freight traffic. The Commission gave no reason for including any of these costs solely related to commuter service in determining the costs of North-South freight traffic.

Under the Commission's own basis for decision, the district court correctly found (A. 345):

> "The critical issue on this cost item was to determine how much of the railroads' cost of commuter service was in fact common with the cost of freight service and how much was solely related to commuter service. But, in accordance with its general approach to these issues, the Commission, by adopting Rail Form A, inflated the Northern railroads' freight costs by the entire commuter deficit of those railroads, without regard to the plain conflict between this action and its own finding that 'many individual items of suburban service can be considered solely related . . . to suburban service.'"

Contrary to the contention of Commission counsel that the district court was "substituting its own view" (ICC Brief, p. 42), the district court decided the case on the standard adopted by the Commission—the costs of North-South freight traffic—and further accepted the *Commission's* view that passenger deficits arising from common costs should be attributed to North-South freight traffic.[19] What the district

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[19] Much of the Northern railroads' argument (B&O Brief, pp. 23-24, 49 n. 24, 53-54, 55) constitutes an attack upon the position stated by the Commission that passenger deficits are included in freight costs *because* of common costs (325 I.C.C. at 78, A. 124).

court did not, and could not, accept was the unexplained and unjustified inclusion of costs "solely related" to commuter service.[20]

Appellants no longer even attempt to defend the attribution of the entire northern commuter deficit to the costs of freight traffic. Instead, they now attempt to explain the Commission's inclusion of commuter deficits unrelated to freight traffic on the ground that commuter deficits represent a kind of "overhead" which must be recovered by proportionate charges to other traffic.

Appellants point to the Commission's statement that the prescribed divisions are based upon fully distributed costs, which include allowances for "overhead," as indicating that the Commission itself included commuter deficits not on a relative cost theory, but on a revenue needs theory (ICC Brief, p. 44; B&O Brief, p. 48). There is no merit in this attempted defense of the Commission's treatment of the cost of commuter deficits. The Commission did not inflate the Northern railroad divisions on the basis of "revenue needs," since these were found to be the same in both terri-

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[20] The Northern railroads also argue that there are solely related deficits in intercity passenger services in the South (B&O Brief, pp. 53-54; see also ICC Brief, p. 44, n. 40). This argument was recited as a contention of the Northern railroads but was not adopted by the Commission as a ground for its decision (325 I.C.C. at 78; A. 123). Even if this theory were sound, it would not lead to the conclusion that passenger deficits in both territories which are unrelated to freight service should nevertheless be used to inflate freight costs. The obvious solution, if there were passenger deficits not related to freight operations in both North and South, would have been to exclude such deficits in both territories. Even under the Northern railroads' argument, the failure to exclude all solely related passenger deficits was prejudicial to the Southern railroads in view of the much greater effect of the commuter deficits in inflating the costs of the Northern railroads (A. 1291).

tories (325 I.C.C. at 15-16; A. 36-37). As the district court held (A. 345):

> "The complete answer to this contention is that the Commission did no such thing. The revenue need issue was hotly contested before the Commission, each group contending that its needs were greater—the Northern railroads, on the basis of lower rates of return; the Southern railroads, on the basis of their growing service responsibilities to an expanding economy. The Commission rejected both contentions . . ."

The stated basis for the Commission's order in this case was the relative costs of handling North-South freight traffic (p. 4, *supra*). The Commission's decision to include "overhead" in the costs in addition to out-of-pocket costs did not imply any departure from its standard that North-South freight costs are determinative. Under the Commission's own standard, the only allowance for "overhead" to be included would be those overhead items inherent in handling North-South freight traffic (such as officers' salaries, general office expenses and other overhead inherent in freight operations). Since the Commission recognized that "many individual items of suburban service" were "solely related" to that service (A. 124)—that is, completely unrelated to any kind of freight traffic—the entire commuter deficits could not be a part of the "overhead" that make up the costs of North-South traffic under the Commission's own standard.

The Commission's action in dealing with other cost factors makes it plain that its decision to include allowances for "overhead" referred only to such items of overhead as are related to North-South freight traffic. For example, the Commission specifically excluded the platform deficits realized or incurred by the Northern railroads in the handling of other traffic because such deficits were not related to

North-South freight traffic (325 I.C.C. at 56; A. 89). The Commission refused to include any part of these deficits as a part of the costs to be determined in this case, not because such deficits do not have to be made up if the financial integrity of the railroads is to be maintained, but because the Commission recognized that no part of these deficits is properly considered a part of the cost of North-South freight traffic (*ibid.*). The same is true with respect to the commuter deficits of the Northern railroads attributable to facilities and operations solely related to suburban service.[21]

Appellants also argue that since commuter deficits constitute a burden which might justify higher rates, such deficits should also be reflected in higher divisions for the railroads incurring the deficits on the theory that rates should be divided in accordance with the manner in which they are made (ICC Brief, p. 43; B&O Brief, p. 47). No such theory was adopted or even suggested by the Commission itself. Moreover, the theory that rates should be divided as they are made cannot be used to support the Commission's action in prescribing an inflated basis of divisions for the Northern railroads based upon commuter deficits or for any other reason because, notwithstanding the Northern commuter deficits, freight rates are no higher

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[21] Commission counsel themselves recognize the true function of the allowances for overhead and return in fully distributed costs when they point out that such allowances should be included in cost determinations only "if appropriate" (ICC Brief, p. 20) and that fully distributed costs can be restated "so as to exclude all or some constant cost items which should not be taken into account" (ICC Brief, p. 21). The inclusion of a constant cost would not be "appropriate" under the standard adopted by the Commission in this case—the costs of North-South freight traffic—whenever the item is unrelated to the transportation service for which costs are being determined. To include constant cost items not related to the service being measured is to prescribe divisions, not by any standard of costs, but by an allocation of general revenue needs.

in the North than they are in the South. Nor is there any increment in the Northern portion of the North-South freight rates which reflects higher Northern passenger or commuter deficits. On the contrary, the rate levels in both territories are shown by the record to be uniform; and the interterritorial rates being divided here are on the same uniform level.[22]

Appellants' reliance on *King* v. *United States,* 344 U.S. 254 (1952) (ICC Brief, pp. 42-43; B&O Brief, pp. 47, 50-52) is misplaced. *King* was a rate case, and this Court has recognized, citing *King,* that "the issues are quite different when, in a divisions case, it is argued that carriers in one part of the country should subsidize the passenger operations of carriers elsewhere." *Chicago & N.W.R. Co.* v. *Atchison T. & S.F.R. Co.,* 387 U.S. 326, 350 (1967). Moreover, in *King,* the rate increase did not purport to be related to the cost of any freight traffic, but was designed "to meet overall revenue needs" (344 U.S. at 264). And, as a factual matter, the *King* case related to an increase in Florida intrastate freight rates. There is no commuter service in Florida, and this Court had no occasion to consider, and did not consider, the treatment of deficits arising from costs solely related to passenger service.

Appellants' efforts to support inclusion of deficits resulting from costs solely related to passenger service as a part of freight costs are not only unsound in principle, but they are improper arguments to address to the Court. Since none of appellants' theories has been set forth by the Commission as a justification for its action, the advocacy of such

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[22] As previously shown (pp. 2-3, *supra*), the Commission ordered, and this Court upheld, uniform class rates for both North and South; and this uniformity of rates is in effect today. The Northern railroads admitted that they sought "disproportionate divisions of a uniform structure of rates" (A. 1543).

theories in this Court constitutes a plain violation of the fundamental principal that "a reviewing court . . . must judge the propriety of such action solely by the grounds invoked by the agency. If those grounds are inadequate or improper, the court is powerless to affirm the administrative action . . ." *S.E.C.* v. *Chenery Corporation,* 332 U.S. 194, 196 (1947); *Burlington Truck Lines* v. *United States,* 371 U.S. 156, 168-169 (1962). This Court held in *United States* v. *Champlin Refining Co.,* 341 U.S. 290, 301 (1951) that "it is not the function of this Court to rescue the Commission by making findings *de novo* which the Commission itself was unable or unwilling to make."

Moreover, appellants misstate the question of transportation policy presented by commuter deficits when they ask this Court to accept the proposition that "[commuter] losses must be recovered from railroad freight operations if railroads are to remain solvent" (ICC Brief, p. 44; also B&O Brief, p. 46). The other policy choice, if commuter service is to be continued, is to place the financial burden of the deficits on the communities receiving the service instead of upon either the Northern railroad stockholders or the freight shippers in the North or the South. Although the Commission gave no explanation of any policy justifying its action in this case, the Commission has specifically addressed itself to the policy considerations underlying the treatment of commuter deficits in other cases and has arrived at a conclusion which is diametrically opposed to the theories advocated by appellants. Prior to its decision in this divisions case, the Commission had adopted the policy that commuter service should not burden freight operations (*Railroad Passenger Train Deficit,* 306 I.C.C. 417, 483 (1959)):

> "That where the railroads are unable to operate a particular local or commuting service at a profit, and

> where such service is essential to the community or communities served, that steps be taken by State and local authorities, or both, to provide the service paying the carrier the cost plus a reasonable profit."[23]

The principle that commuter service is a separate service that should not be subsidized by other services is consistent with Congressional policy as stated in House Report No. 1922, Committee on Interstate and Foreign Commerce, on the Transportation Act of 1958, 85th Cong., 2d Sess., p. 11 (1958):

> "It is obvious that in very great measure these passenger losses are attributable to commuter service. It is clear that where such necessary services cannot be made to pay their way, the interested communities have a very real interest in working out the problem. It would seem evident that if such urban or interurban commuting service must be preserved, losses incurred will have to be met in some way by the communities. It is unreasonable to expect that such service should continue to be subsidized by the freight shippers throughout the country."

The Commission has continued to express its policy that commuter deficits should be borne by the local communities, not freight shippers throughout the country, in its decisions[24] and in recent reports to Congress.[25]

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[23] This policy statement was transmitted to Congress in the Commission's 1959 Annual Report (p. 34). As shown in this policy statement, contrary to the present argument of the Northern railroads (B&O Brief, p. 40), the Commission itself has identified commuter service as a separate problem raising separate policy considerations.

[24] *New York, N. H. & H.R. Co. Loan Guaranty*, 312 I.C.C. 369, 372 (1960); *Pennsylvania R. Co.-Merger-New York Central R. Co.*, 327 I.C.C. 475, 526 (1966).

[25] Hearings before the Senate Subcommittee on Housing and Urban Affairs, Committee on Banking and Currency, on Solutions

Pursuant to this policy, commuter service is today subsidized by the local communities in each of the major commuter areas of the North.[26] Since these subsidies did

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to Problems of Improved Commuter Service in Mass Transportation, 90th Cong., 2d Sess. (March 26, 27, 28, 1968) (hereinafter cited as Hearings), pp. 213, 218-219, 220. The Chairman of the Commission summarized the policy of the Commission as follows (Hearings, p. 42):

> "We feel that the public must be willing to assist private carrier management, in appropriate circumstances, in a cooperative joint effort to revitalize and further improve essential rail commuter service. The appropriate public-private policy mix will vary with particular carriers and needs of the urban area. In some cases, direct operating subsidiaries or capital grants for new equipment and facilities will be required; in others, more equitable policies in the treatment of carriers' property for local tax purposes and a favorable local regulatory policy may suffice. It is perfectly clear that rail commuter transportation is a critical element in urban transportation and, if allowed to be eliminated, will impose heavy economic and social cost upon our urban areas and our population. It is for this reason that we believe that this type of joint private-public undertaking, much of which is already going on in many parts of the country, should be continued and expanded in years to come."

See also Report and Recommendation of Interstate Commerce Commission to Senate Committee on Commerce and House Interstate and Foreign Commerce Committee (June 25, 1968), pp. 4-6.

[26] In Boston, the Boston and Maine and the New Haven have been authorized to discontinue commuter service and the Massachusetts Bay Transit Authority has contracted with these carriers for the continuation of service (Testimony of Commission Chairman Tierney, Hearings, pp. 29, 39). In New York, the state has purchased and operates the Long Island Railroad (Testimony of William J. Ronan, Hearings, p. 130). Moreover, New York and Connecticut jointly are paying subsidies to the New Haven and, pursuant to an announced $80 million modernization program, are negotiating for long-term control of the New Haven's west end commuter service (Testimony of William J. Ronan, Hear-

not exist at the time the record in this divisions case was made, the practical effect of the Commission's action here is to provide a double subsidy for the Northern railroads, one from the local communities, consistent with the policy expressly articulated by the Commission elsewhere, and a second as a result of the Commission's unexplained action in this case of including the Northern railroads' pre-subsidy deficits arising from costs solely related to commuter service as part of the costs of North-South freight traffic.

The policy question inherent in the treatment of solely related passenger deficits is far too important to brush aside without explanation as the Commission did in this case. The Court recognized the intrinsic importance of the passenger deficit issue in *Chicago & N.W.R. Co.* v. *Atchison, T. & S. F. Ry. Co.*, 387 U.S. 326 (1967). In that case, in which

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ings, pp. 130, 136). In Philadelphia, the Southeastern Pennsylvania Transit Authority has entered into commuter service agreements with Penn Central and Reading (Testimony of Alan S. Boyd, Hearings, p. 6; Testimony of Robert W. Minor, Hearings, p. 56). In New Jersey, the State has contracted with Erie Lackawanna and Central Railroad of New Jersey for the performance of commuter service and has also instituted substantial tax reductions and capital improvement programs (Brief of the State of New Jersey, pp. 1-2, I.C.C. Finance Docket 23832, et al., June 7, 1968; Testimony of Chairman Tierney, Hearings, p. 39. See *Erie-Lackawanna R.R.* v. *United States*, 279 F. Supp. 316, 341-342 (S.D. N.Y. 1967), affirmed 389 U.S. 486 (1968)).

As illustrated by the $28 million federal grant for the improvement of New Haven commuter service, the federal government is increasingly providing assistance to northern communities by planning and funding commuter service (Testimony of Alan S. Boyd, Hearings, p. 6). See also Urban Mass Transportation Act, 49 U.S.C.A. §§ 1601-1611 (Supp.).

the Commission had *excluded* passenger deficits in considering both costs *and* revenue needs, the Court stated (387 U.S. at 350):

> "And while the Commission has sometimes acted to offset passenger deficits in freight rates cases,[29] the issues are quite different when, in a divisions case, it is argued that carriers in one part of the country should subsidize the passenger operations of carriers elsewhere."
>
> "[29] E.g., *Increased Freight Rates, 1948*, 276 I.C.C. 9, 35. See also *King* v. *United States*, 344 U.S. 254, 263-264."

The Court accepted the Commission's explanation of its action in excluding passenger deficits in that case, noting that (387 U.S. at 350-351):

> "If the Commission were to give controlling weight to passenger deficits in a divisions case, it might be appropriate to take more evidence on the issue and discuss it in greater depth than the Commission did here. But in light of the fact that, in this case, passenger deficits were of negligible relevance to the Commission's decision to increase the Midwestern divisions, we find no errors in the Commission's findings and procedure on this point . . ."

In this North-South case, however, the Commission's treatment of deficits arising from costs solely related to passenger service is far from being "of negligible relevance," and the Commission has not provided any discussion supporting the inclusion of such costs as part of the costs of North-South traffic.

In summary, the Commission has prescribed divisions of North-South freight revenues on the basis of costs which include passenger deficits. The Commission has explained why the deficits with respect to costs common to both freight and passenger services should be allocated as part

of the costs of North-South freight traffic, but has given no explanation why costs solely related to passenger service should be included. Section 8(b) of the Administrative Procedure Act requires reasoned findings upon such a material issue (5 U.S.C. § 557(c)), and exposition of Commission policy is especially required where, as here, the Commission has acted in a manner contrary to its own previously articulated policy. *Secretary of Agriculture v. United States,* 347 U.S. 645, 654 (1954).

B. The Commission Acted Arbitrarily and Without the Support of Substantial Evidence When It Ascribed 58 Percent Higher Costs to the Northern Railroads for Interchanging Freight Cars at the Territorial Border.

The Commission's treatment of the costs of interchanging North-South traffic at territorial border points constitutes a plain violation of the requirement that its findings and conclusions be supported by substantial evidence and reasoned findings.

The physical facts are simple and uncontroverted. Most North-South traffic moves in freight cars which are interchanged between Northern and Southern railroads at territorial border points. For example, a car moving between New Orleans and Philadelphia over the Southern Railway and Penn Central would be interchanged at Potomac Yard, immediately south of Washington, D.C. Potomac Yard is a joint facility which charges each railroad using the facility the same amount per car for performing the service of interchanging the car (A. 746-749). Another example would be a car moving between New Orleans and Cleveland over the Louisville & Nashville and Penn Central railroads. Such a car would be interchanged at Cincinnati,

a terminal area in which both the L&N and Penn Central maintain yards (A. 757-759). Railroad operating officers presented testimony reviewing all of the important interchange areas and showing that the interchange operations performed by the Northern railroads were no more costly than those of Southern railroads in interchanging the same cars at the same points.[27]

In the face of this uncontroverted evidence, the Commission prescribed divisions which include a separate allowance for the costs of "border interchange" which are 58% higher for the North than for the South.[28] This figure is based upon Rail Form A territorial average interchange costs reflecting all interchange services in the respective territories. Whatever might be the cause of the higher Northern costs on the average of all traffic, the bulk of which is intraterritorial traffic, the physical facts of the interchange of North-South traffic at the territorial border points show that the Northern railroads' costs could not be higher than the Southern railroads' costs of performing interchanges at the same border points.

The Commission made no findings and cited no evidence supporting any higher costs, much less 58 percent higher

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[27] This testimony covered all of the significant points at which North-South traffic is interchanged, i.e., Potomac Yard, Cincinnati, Evansville, Louisville, Elkhorn City, St. Paul, Richmond, Petersburg, Jarrett, and East St. Louis (A. 729-740; 741-745; 746-753; 757-761; 762-770; 771-775).

[28] In its initial report, "Terminal and border interchange" are shown as a combined figure (325 I.C.C. at 37; A. 63). From the appendix to the Commission's supplemental report, it can be calculated that the factor representing "border interchange" (also referred to as "cost of interchange at gateways") is 8.54 for the North and 5.41 for the South (325 I.C.C. at 456; A. 185) (line 11 ÷ line 23). 8.54 is 57.8 percent higher than 5.41.

costs, for the Northern railroads with respect to border interchanges. Instead, the Commission's discussion of the subject of the cost of border interchange criticizes the Southern railroads' "estimate" of the costs of such interchange, without in any way attempting to support its own use of 58 percent higher costs for the North.

This disposition of the cost of border interchanges would not be a lawful one, even if the Commission's "criticisms" of the Southern railroads' estimate of equalized border interchanges were sound, which they are not.[29]

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[29] In fact, the Commission's criticisms of Southern railroads' "estimate" are themselves arbitrary. The first three criticisms simply seek to minimize (but not to eliminate) the effect of the practice of equalizing switch engine hours as a factor which equalized costs of interchange at border points (325 I.C.C. at 81; A. 128). (This practice was emphasized by both Northern and Southern operating witnesses, A. 987, 757-758). But assuming that there are factors other than switch engine hours affecting relative costs of interchange in the same interchange areas, neither the Commission's report nor the Northern railroads' evidence even attempts to identify any factor which could make the Northern railroads' costs any higher, much less 58 percent higher, than the Southern railroads' costs of interchange in the same areas.

Nor does the Commission's final criticism fill the void created by this failure to suggest any factor possibly causing higher Northern costs. This criticism is that the assigning of costs of border interchanges to North-South traffic which differ from the average costs of all interchanges on all traffic throughout the North and South results in a distortion unless some corresponding adjustment is made in the cost of all the other interchanges included in the territorial averages (325 I.C.C. at 81; A. 129). The Commission expressed its concern that "some" dollars will be "left over and not assigned to anything" (*ibid.*). This is statistical nonsense in this case in which the North-South traffic constitutes only 6 percent of the total traffic of the North. The obvious answer to the problem raised by the Commission is to assign any balance to the traffic *other* than North-South traffic, which constitutes 94 percent of the total traffic of the North and which obviously governs the level of the Northern railroads' average costs in any event.

The Southern railroads made no claim before the Commission that their particular method for estimating the level of border interchange costs had to be accepted. The claim was that there was no substantial evidence to support any higher level of border interchange costs for Northern than for Southern railroads, whatever the precise dollar amount of the equal costs. The Commission's criticisms do not dispose of this claim, nor do they supply any support for its affirmative action in granting the Northern railroads a separate allowance for border interchanges which is 58 percent greater than the allowance given the Southern railroads for providing the same service at the same border points.

Appellants merely rely on the Commission's criticisms of the Southern railroads' estimates and do not even attempt to cite any evidence supporting the use of any higher, much less 58 percent higher, costs for the Northern railroads in interchanging traffic at territorial border points (ICC Brief, p. 46, n. 43; B&O Brief, p. 42). Thus, as this case stands, the only evidence related to border interchanges shows equality of costs. In the absence of any evidence whatever in this record to support the Commission's action in awarding the Northern railroads a 58 percent inflation on this cost item, that action must be set aside as unsupported by substantial evidence.

C. The Commission's Use of Territorial Average Car Costs 32 Percent Higher in the North Violates Both the Administrative Procedure Act and the Interstate Commerce Act.

Another important instance of the Commission's unlawful use of territorial average costs is reflected in its treatment of car costs (325 I.C.C. at 60-64; A. 94-101). Car costs embrace the costs associated with the railroad freight

car itself, including repairs, depreciation, and an allowance for return on investment.[30] Since each shipment of North-South traffic at issue in this case moves between the territories in the same freight car, which may be owned by a railroad in either territory or, indeed, by a Western railroad not even involved in this case, common sense would indicate that the car costs of Northern and Southern railroads would be equal.

However, the Commission did not base its order in this case on the cost of the cars handling North-South traffic. Instead, the Commission used the average cost of *all* per diem cars handling *all* traffic in each territory, although the majority of the cars included in the average costs in each territory are open-top cars that do not carry North-South traffic to any appreciable extent (A. 858-860). This use of territorial average costs for all cars instead of making a rational determination of the costs of the cars used in handling the traffic here at issue led the Commission to adopt car costs which are 32 percent higher in the North than in the South (325 I.C.C. at 60; A. 95) in the absence of any evidence that the higher Northern territorial average car costs have anything whatever to do with the relative costs of the cars handling North-South traffic.

A major reason that the average car costs of the Northern railroads are higher than the average car costs of the Southern railroads is that several of the coal-originating

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[30] The car cost issue as it arises in this case concerns "per diem" cars—that is, box, flat, hopper and gondola cars on which owning railroads receive a per diem rental for the use of the car. The cost of "mileage" cars (refrigerator and tank cars) raises no problem because the Commission used a uniform mileage charge in both North and South for such cars (A. 855). The preponderance of the per diem cars carrying North-South traffic are box cars (325 I.C.C. at 60; A. 95).

Southern railroads own fleets of hopper cars which are used to terminate coal on Northern railroads. These Southern railroads thus rent their open-top cars to Northern railroads far more often than the Northern railroads rent cars to Southern railroads. Thus, the record shows that the Southern railroads' annual car rental (per diem) net credit is more than seven times greater than the net balance of the Northern railroads—$23,987,115 as compared to $3,405,826 (A. 863).

The greater net per diem balance of the Southern railroads substantially depresses their average car costs. This is so because, as the Commission itself pointed out (325 I.C.C. at 63; A. 100):

> "per diem [car rental] charges have been based upon car costs computed on a reproduction basis insofar as depreciation and return on investment of the cars are concerned. This differs from the original cost basis used in Form A car cost computations for owned cars."

Because the reproduction cost of freight cars far exceeds original cost, a car-owning railroad receives rental payments which greatly exceed its car costs on that car computed on an original cost basis (A. 862). When these rental "profits" are credited to the car cost accounts, they lower the total costs in that account. Consequently, when unit car costs are determined by dividing the total car-miles of service performed by a railroad into the total costs in the car account, the car-owning railroads appear to have substantially lower unit car costs.[31] This is a reason why the Southern rail-

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[31] A dramatic example of the extent to which per diem rentals received on other cars reduce average car costs is the situation of the Clinchfield Railroad which, because other railroads regularly use the coal cars which account for most of the Clinchfield's business, actually shows a *negative* cost for the Clinchfield's average

roads' territorial average car costs are lower than the territorial average car costs of the Northern railroads.

Coal traffic is not involved in this case (325 I.C.C. at 55; A. 86), and the relative use of cars carrying coal, while significant in its influence on the territorial average cost of all cars in the North and in the South, has nothing whatever to do with the relative cost of the box cars that predominate in the handling of North-South traffic (325 I.C.C. at 60; A. 95).

While the territorial average car costs are strongly influenced by the car rental balance resulting from the Northern railroads' use of the Southern railroads' coal cars, car rental balances have just the opposite effect with respect to the North-South traffic here at issue. The Commission itself found that on North-South traffic "there is a greater relative use . . . of cars owned by official territory railroads than those of cars of southern ownership" (325 I.C.C. at 64; A. 100-101). Thus, on North-South traffic, it is the Northern railroads whose costs are reduced by the fact that the level of per diem rentals is higher than the cost of the cars. In this situation, the territorial average car costs of the Southern railroads, which are substantially reduced by car rentals on cars handling other traffic, cannot conceivably measure the car costs incurred on North-South traffic, as to which the Southern railroads themselves must make substantial car rentals payments.[32]

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car (A. 862). It would be preposterous to suggest, with respect to a movement of North-South traffic moving in a box car owned by the Clinchfield, or more likely a car on which the Clinchfield must pay rental charges, that the railroad nevertheless incurs less than no cost at all. Yet this is the arithmetic effect of applying the average cost of all cars to the cars carrying North-South traffic.

[32] The Commission itself had previously recognized that average car costs are depressed by net per diem balances. Thus, in *Louisville & N. R. Co.* v. *Southern Ry. Co.*, 319 I.C.C. 639, 654

The Commission did not even purport to find as a fact that the car costs associated with North-South traffic are 32 percent higher in the North. The Commission instead merely stated that "there are very real differences in the car costs in each territory and the causes are known" (325 I.C.C. at 63; A. 100). But the three "causes" listed by the Commission do not provide any rational support for a 32 percent inflation in the Northern car costs.

The first "cause" assigned by the Commission is "a difference in utilization of 39.4 car-miles per day in the North and 49.5 car-miles per day in the South" (325 I.C.C. at 63-64; A. 100). These figures are *not* related to North-South traffic. The Northern railroads' witness who presented these figures admitted that they represent territorial averages for "all traffic in all types of cars and without separation of line-haul and terminal" (A. 1027-1028). That is to say, the utilization figures employed by the Commission are the average miles per car computed by dividing all car miles by all car days in a territory whether a car is moving on line or standing in some terminal. It is arbitrary and irrational to defend the application of average car costs to North-South traffic by citing car utilization

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(1963), the Commission held that, because the *L&N* was a car-owning railroad, its average car costs, as computed under the Commission's "Rail Form A" original cost method, were depressed by car rental payments, computed on a reproduction cost basis. The Commission there held that it should "deviate from Rail Form A" in computing car costs for divisions purposes in order to nullify this essentially irrelevant factor (319 I.C.C. at 654). This decision was challenged on the ground that the Commission improperly departed from the average car costs, but the Commission was upheld on judicial review. *Carolina & Northwestern Ry. Co.* v. *United States*, 234 F. Supp. 112 (W.D.N.C. 1964), affirmed, 380 U.S. 526 (1965).

figures that relate to "all traffic in all types of cars." These average car utilization figures have no more relationship to North-South traffic than the average car costs. There is no finding, and no evidence, to indicate that the car utilization (car miles per day) of the Northern railroads is any less than that of the Southern railroads with respect to the cars handling the North-South traffic in issue.[33]

The second "cause" relied upon by the Commission to explain the average car cost differences as between the territories is "differences in tax and wage rates" (325 I.C.C. at 64; A. 100). There is no evidence of record to support any difference in tax rates on railroad freight cars. The evidence in the record relates to the tax rate per dollar of investment in all railroad property, and that evidence shows that the tax rates are *higher in the South* (A. 1295). The only evidence of differences in wage rates shows a 3 percent higher wage rate for maintenance of equipment in the North (A. 943), and this fails to take any account of the relative prices of materials in the South and in the North (see A. 1030-1031; 793-794). Moreover, a 3 percent differential, even if properly related to a part of the car costs, cannot justify a 32 percent inflation for the North for all car costs.

The third and final "cause" assigned by the Commission as an explanation for differences in car costs in the respective territories is "a difference in the relative amount of off-line use of owned cars in all territories," specifically, "a greater relative use in connection with the traffic here at issue of cars owned by official territory railroads than

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[33] The Northern railroads' own evidence indicates that the North-South traffic is handled in through trains in the North (A. 983-985), whereas traffic not at issue here but important to the Northern average experiences very low utilization of cars (A. 797-805).

of cars of southern ownership" (325 I.C.C. at 64; A. 100-101). But, as already shown, far from supporting the Commission's use of territorial average car costs, this fact clearly demonstrates the error of that action, for it shows that North-South traffic is unlike, not like, the total traffic from which the territorial averages are computed.

The above-described treatment accorded to the issue of car costs by the Commission is unlawful on at least three grounds. In the first place, because the Commission action in imputing 32 percent higher car costs to the Northern railroads is not justified by its own findings, this action violates the requirement of Section 8(b) of the Administrative Procedure Act that there be reasoned findings to support administrative action. Secondly, because there is no evidence in the record to support a finding of 32 percent higher Northern car costs in handling the same cars carrying North-South traffic, and because the record shows instead that this higher territorial average figure is the product of a car rental situation which is not characteristic of the North-South traffic here at issue, the Commission's use of the territorial average figure is arbitrary and without the support of substantial evidence, as required by Section 10(e) of the Administrative Procedure Act.

Finally, the Commission violated Section 15(6) of the Interstate Commerce Act by failing to differentiate the railroads' separate functions as car-owning or renting agencies (a rental transaction) and as transportation agencies. In a divisions case under Section 15(6), the responsibility of the Commission is to determine the costs incurred by the respective railroads "in the service of *transportation*" (emphasis supplied). This determination has nothing whatever to do with the separate problem of the financial results each railroad experiences in car

rentals. Yet, the territorial average car costs used here are dominated by the results of car rentals, and the Commission openly and mistakenly relied upon the results of car rentals to justify its use of such average figures.

This action was directly contrary to Section 15(6) for reasons that Commission counsel and the United States recently stated to this Court. In defending the Commission's action in adjusting average car costs to offset the effect of net per diem balances in the *L&N* case previously cited (p. 50, n. 32, *supra*), Government counsel replied as follows to the contention that territorial averages should have been used (Motion to Affirm of United States and I.C.C. in *Carolina & Northwestern Ry. Co.* v. *United States*, No. 838, Oct. Term 1964, pp. 9-10):

> "This argument confuses two wholly unrelated subjects, namely, *freight* revenues and *rental* revenues. Section 15(6) of the Act, as it applies here, deals with rate divisions on the basis of carriers' respective costs and revenues in providing *'the service of transportation'* (emphasis added). 49 U.S.C. 15(6). The L.&N. participates in a 'transportation service' only between the coal mines and Knoxville. Beyond the interchange point on the Southern's lines, L.&N. is merely renting its facilities to another railroad. Whether the L.&N. made or lost money on the rental transaction does not affect L.&N.'s costs in providing 'the service of transportation' on its own lines."

This Court affirmed the judgment of the three-judge court sustaining the Commission's action in the *L&N* case (380 U.S. 526 (1965)). In the present case, however, in failing to exclude the effect of the car rental income on the average costs of the Southern railroads, and in thus commingling the entirely separate rental factor with "the service of transportation," the Commission committed the very legal

error which it emphasized and carefully avoided in the *L&N* case.

D. The Commission's Determination Of Switching Costs Is Not Supported By Reasoned Findings Based Upon Substantial Evidence.

The district court found that the Commission had committed legal error in its treatment of the issue of "switching costs." The specific cost factor in controversy before the Commission was the switching service actually performed in originating and terminating North-South freight traffic. As the Commission elsewhere acknowledged in its report:

> "There is a great variation from one point to another in the amount of both terminal switching and interchange switching due to the physical layout of the tracks, volume handled, and other causes" (325 I.C.C. at 59; A. 94).

The factual question before the Commission was the measure of the switching costs actually associated with cars handling the North-South freight traffic in issue.

In line with their general cost approach, the Northern railroads placed their entire reliance upon the territorial average switching service for the average car in each territory. The Southern railroads, on the other hand, sought to develop the costs associated with the particular traffic in issue. However, the Southern railroads only had access to the data necessary to develop the switching service per car of North-South traffic for the service performed in the South, and, accordingly, the studies which they made, based upon a scientifically selected sample of North-South freight traffic (325 I.C.C. at 73; A. 115), were limited to the South. These studies showed that substantially greater

switching services were performed by the Southern railroads in originating and terminating North-South traffic than were performed in handling average traffic within the South (325 I.C.C. at 72; A. 114). In the face of these special studies, the Northern railroads continued to rely upon the territorial average switching costs which were substantially higher in the North (325 I.C.C. at 73; A. 116). Consequently, the record does not show the switching services performed by the Northern railroads in handling North-South traffic. Instead, the Southern railroads were obliged to make an estimate as to the cost of these services, which estimate, based on the best information available to the Southern railroads, showed that the territorial average switching costs did not accurately measure the costs of switching North-South traffic (A. 875-876, 883).

In another case, the Commission criticized the use of territorial average switching costs and stated that the parties in possession of the facts "should have made detailed switching studies to determine the switching minutes per car" (*Commodities—Pan-Atlantic Steamship Corporation*, 313 I.C.C. 23, 57 (1960)). However, in the present case the Commission rejected the Southern railroads' switching studies and used Rail Form A territorial average switching costs in prescribing the new divisions (325 I.C.C. at 77; A. 121). A basic reason for the rejection of the Southern railroads' studies was that "the adjustment in the North was not made on a basis comparable to that in the South, and here, where the relationship of North and South is of prime importance, this is a major defect" (325 I.C.C. at 76; A. 121). This treatment of the question of comparability was unlawful because it placed upon the Southern railroads the impossible burden of making switching studies in the North. And the absence of any independent

evidence in the record to support the applicability of territorial average switching costs leaves the Commission's order without the support of substantial evidence.

Commission counsel correctly state the issue presented to the Commission when they point out: "The Southern lines urged that their Rail Form A territorial average switching costs were depressed by the large proportion of volume movements of certain commodities in their territory to the point that those costs were not representative of North-South traffic which includes only a small amount of such commodities" (ICC Brief, p. 39). However, Commission counsel make no effort to explain how this issue was resolved with reasoned findings based upon substantial evidence. Instead, they simply quote from the Commission's report the very language in which the Commission refused to pass upon the issue because of the lack of comparable evidence (ICC Brief, pp. 39-40).

The Northern railroads seek to confuse the issue by reference to their train utilization study (B&O Brief, p. 32) and to the Commission's statement that North-South traffic "is a large and varied body of the traffic moving and coming from terminals in all parts of both territories" (B&O Brief, p. 40), intimating, but not saying, that the train utilization study constitutes independent evidence to support the application of territorial average switching costs to the North-South traffic at issue. This is plainly not the case. The fact that North-South traffic might at some time be hauled over every route in both territories would not lend any support to the use of average switching costs in the terminals in each territory, since the issue, as Commission counsel point out, is not whether there is some peculiar characteristic of North-South traffic which affects its switching costs, but whether the territorial averages for

the North and South are affected by differences in the characteristics of *intraterritorial* traffic that are not applicable to North-South traffic.

In *Boston and Maine R. Co.* v. *United States,* 208 F. Supp. 661 (D. Mass. 1962), affirmed, 371 U.S. 26 (1962), the Court reviewed a Commission decision in which the same Northern railroads had contended for the use of Rail Form A territorial average costs on the ground that the only comparable cost data as between Northern and Southern carriers were those on the basis of territorial averages (see 309 I.C.C. at 509). The Commission rejected the use of territorial average costs and prescribed instead the uniform divisional scale applicable to North-South traffic. The order was sustained on judicial review with specific reference to switching costs (208 F. Supp. at 675):

> "In the supplemental exceptions, dated March 9, 1959, filed by N.Y.C. to the proposed report of the examiner, it is stated (at page 24) that L&N's restatement of the northern railroads' cost study 'destroyed any possible comparison by adjusting the L&N costs without making similar adjustments in the N.Y.C. costs.' N.Y.C. went on to say that 'it would be unrealistic to expect the New York Central to study the movements at the 130 points involved' on its railroad. N.Y.C. argues that since the burden of proving the unreasonableness of existing divisions was upon the complainant L&N, it was incumbent upon the latter carrier to produce evidence of the relative costs of handling the traffic in question. L&N, however, did introduce in evidence its own actual costs in place of average costs. The costs put in evidence by N.Y.C. were unadjusted average costs for the northern railroads which did not reflect the actual costs. The Commission found that this evidence was not helpful in determining the costs of the particular traffic involved in this case. N.Y.C. now takes the position that the burden of adjusting the

> average costs presented in evidence by the *plaintiffs* [Northern lines] was on the L&N, even though the data necessary to make these adjustments were not available to the L&N and could only be produced by the plaintiffs themselves. We think this position is untenable."

The same position of the same Northern railroads is untenable here.

The decision of the court below in this case is thus in accord with the treatment of switching costs previously affirmed by the Court. In the absence of any evidence relating territorial average switching costs to the relative costs of the Northern and Southern railroads in handling the North-South traffic here in issue, the district court was clearly correct in setting aside the Commission's order.

E. The Commission's Determination of The Empty Return Ratios Applicable to North-South Traffic Is Wholly Unsupported.

A significant factor in calculating the cost of transporting a loaded freight car is the empty movement of freight cars associated with the loaded movement. This factor, stated in the form of an "empty return ratio" (the ratio of the empty mileage related to the loaded mileage of the traffic in question), is applied to the unit costs for loaded movements and has an important effect upon the determination of railroad costs. Even though the cost of hauling a loaded car in one territory might be exactly the same as the cost of hauling the same car in another territory, such uniformity of cost is drastically altered if a higher ratio of empty to loaded mileage is applicable to the costs in one territory. To an important extent, the higher costs of the Northern railroads result from the Commission's use of higher Northern territorial average empty return

ratios. The district court held that the Commission's determination to use these territorial average empty return ratios in developing the costs of North-South traffic was unlawful (A. 355). Again, an analysis of the Commission's statement of the issue clearly demonstrates that the district court's holding was correct.

Since the bulk of the North-South traffic moves in box cars (A. 95), the primary controversy over empty return ratios concerned the Northern railroads' use of territorial average empty return ratios for all box cars in determining the cost of the box cars carrying North-South traffic. The territorial average ratios are 39 percent in the North and 33 percent in the South (325 I.C.C. at 64; A. 102), meaning that the Northern average is 18 percent higher than the Southern average. The Commission used these ratios without any evidence at all that they are applicable to North-South traffic and in the face of evidence which showed that the application of the territorial averages to North-South traffic is inherently misleading.

A basic problem in dealing with territorial average box car empty return ratios is that numerous box cars are specially assigned to shuttle between particular points and thus have a 100 percent empty return ratio. Automobile parts manufactured in the Detroit area are carried almost exclusively in assigned box cars to automobile plants in New Jersey, Kansas, Texas, California and Georgia, and those box cars return empty to the Detroit area origin point (A. 746, 1011-1018). In contrast, most other box cars are in general service and experience much lower empty return ratios.[34] The result, as a matter of simple arithmetic, is

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[34] The Commission described this basic situation as follows (325 I.C.C. at 64; A. 102):

> "In this category of boxcars are general purpose cars which can be utilized by and are available to all shippers for loading

that the territorial average box car empty return ratio of any territory will be substantially influenced by the proportion of box cars which have a 100 percent empty return ratio. All other things being equal, the territory with the highest proportion of assigned cars to total box cars will have the highest territorial average box car empty return ratio. Thus, even if the North and the South in fact have the *same* empty return ratios on general purpose box cars, and the *same* 100 percent empty return ratio on assigned box cars, the application of the territorial average empty return ratio of all box cars would produce an artificial inflation for the North if the Northern railroads have a significantly higher proportion of assigned cars (A. 847, 1306-1308).

The record does not show the precise extent to which the higher average box car empty return ratios of the Northern railroads are actually the product of this purely statistical phenomenon. The Southern railroads did not have this evidence in their possession, and the Northern railroads did not come forward with it.[35] The Southern railroads did show that virtually all of the automobile

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all types of commodities not requiring special type equipment, and boxcars suitable for loading special commodities, which, though they may be suited for some type of return load, are in assigned service and thus returned empty, with some exceptions, to the point of loading. Included therein are cars used for transporting auto parts, which are specifically designed to handle such commodities."

[35] Indeed, the Northern railroads flatly rejected a proposal, made by the Southern railroads at the first hearing, that a joint study of box car empty return ratios be conducted (A. 991-994, 847-849). The Northern railroads refused to furnish the data for the box cars on their lines in the form requested, or to make any alternative proposal for separating the territorial average box car empty ratio.

parts manufacturing plants are in the Detroit area and that the Northern proportion of automobile parts traffic is substantially higher than the Southern proportion (A. 849). And the Southern railroads showed that the railroads which predominantly serve Detroit and handle a greater proportion of the automobile parts traffic report box car average empty return ratios substantially higher than even the territorial average for the North (A. 104).[36]

The Commission was plainly in error when it rejected the only factual showing with respect to the influence of assigned cars on the Northern averages which the Southern railroads were in a position to make. The Commission's response to this showing was as follows (325 I.C.C. at 66; A. 105):

> "The comparison is based on only three observations and is therefore too limited to be representative. At best, *it may be a coincidence or caused by some unknown factor,* and is not otherwise supported" (emphasis supplied).

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[36] The Northern lines were well aware that the proportion of special cars was greater in the North and that this fact inflated the average box car empty return ratio in the North to a greater extent than for the South (A. 1024-1026). Indeed, it was this knowledge of the impact of the Southern railroads' request for a special study of empty return ratios that dictated the Northern railroads' refusal to produce the facts, as their witness admitted (A. 1023):

> "When this request is made, it is made for a definite purpose. We have to consider the object when we consider whether we want to comply."

The Northern railroads thus frustrated the Southern railroads' efforts to obtain the basic data on box car empty return ratios and then criticized every effort of the Southern railroads to estimate the box car empty return ratios actually applicable to the North-South traffic in the absence of a study which only the Northern railroads could make.

Of course, the Northern railroads, and the Northern railroads alone, were in a position to show that an "unknown factor" was the cause of the unusually high empty return ratios of the railroads serving Detroit. Presumably, if such ratios could have been explained on any ground other than the high proportion of assigned cars that they handle, such explanation would have been offered. In the face of the Northern railroads' refusal to present evidence on this subject, the Commission nevertheless concluded (325 I.C.C. at 67; A. 106):

> "There are undoubtedly instances where specially equipped or directly assigned boxcars have a 100-percent empty return. . . . The five items above tend to show that these cars may have some effect on the empty return ratio, but they do not support a conclusion that any adjustment is warranted here as to the amount of the effect other than that reflected in the averages used."

If the high proportion of automobile parts traffic of the Northern railroads serving Detroit was not the cause of the Northern railroads' higher average box car empty return ratios, the Northern railroads and only the Northern railroads were in possession of the data necessary to explain this phenomenon. To impose upon the Southern railroads the burden of proof with respect to facts as to which the Northern railroads had the duty to come forward was unlawful (p. 23, n. 8, *supra*). But quite apart from any considerations of burden of proof, the Commission's rejection of the Southern railroads' explanation of the higher territorial average empty return ratio for the North does not support the Commission's order. In the absence of *any* evidence, whether submitted by the Northern railroads or otherwise obtained, showing that the empty return ratios with respect to box cars carrying North-South traffic are higher in the North, the Commission's action

in granting the Northern railroads an inflation in their divisions because of higher box car empty return ratios is not supported by substantial evidence.

The district court correctly recognized the essential unlawfulness of the Commission's treatment of empty return ratios (A. 346), quoting from Commissioner Murphy, who summarized the situation in his dissenting opinion as follows (325 I.C.C. at 54; A. 85):

> "The higher than average empty return ratios used for cars moving over the official lines is another instance where true costs have not been used. The official lines handle approximately 800,000 carloads of automobile parts annually which originate in the Detroit, Mich., area and are destined to assembly plants in various parts of the country, including New Jersey, California, and Georgia. Many of these cars are fitted with special devices to protect the automobile parts in transit. Because these cars carrying parts contain special devices and are assigned to particular plants manufacturing such parts in official territory, they normally experience an empty return movement which is, for all practical purposes, 100 percent. No adjustment is made in the cost data to cover the higher empty return costs of this type of equipment. Territorial average box car empty return ratios, as used in the report, overstate the costs of the official railroads when applied to Official-Southern traffic."[37]

[37] Commissioner Murphy's point is particularly significant because, in an earlier divisions case involving a Southern railroad and all Northern railroads, the Commission itself had criticized the Northern railroads for failing to adjust the territorial average empty return ratios because of the "cars specifically equipped for automobile parts, which cannot be used for return loading." *Louisville & N. R. Co.* v. *Akron, C. & Y. R. Co.*, 309 I.C.C. 491, 509 (1960) affirmed sub. nom. *Boston and Maine R. Co.* v. *United States*, 208 F.Supp. 661 (D. Mass. 1962), affirmed 371 U.S. 26 (1962).

Appellants object to this disposition of the issue by the district court, claiming that the district court failed to discuss "the reasons expressed by the Commission or the rationale supporting its conclusion" (ICC Brief, p. 38 n. 34; B&O Brief, p. 41). But the problem here is that the Commission did not express reasons or supply a rationale for its refusal to consider the impact of automobile parts traffic on the territorial average empty return ratios, and that is precisely why the district court held its action to be unlawful. The district court was eminently correct in quoting and relying upon Commissioner Murphy's opinion, since there has not been, and on this record there could not be, an answer to his criticism of the application of territorial average empty return ratios to North-South traffic.

The plain fact is that the Commission's action in using average box car empty return ratios as the measure of such

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The Commission seeks to distinguish this *L&N* case on the ground that automobile parts are "not at all dominant" in the present case, comprising only 33,983 cars of the North-South traffic (325 I.C.C. at 67; A. 106). Actually, this is as many cars as were involved in that entire litigation (309 I.C.C. at 493). Even if only 33,983 cars of North-South traffic are involved, there is no basis for using a territorial average which is higher in the North while conceding that 33,983 cars have a uniform 100 percent empty return ratio in both the North and the South.

Moreover, the Commission's statement is no answer at all to the basic problem created by the 100 percent empty return ratio of the assigned cars in the North which inflates the territorial average applied by the Commission to box cars in general service. Indeed, the relatively small number of such cars in the traffic in which Southern railroads participate as compared to other traffic handled by the Northern railroads is the very source of this problem, and this is the point Commissioner Murphy was making. It shows that the Northern railroads' territorial average empty return ratio for all box cars is higher than that of the Southern railroads for a reason that has no relationship to the general purpose box cars used in handling North-South traffic.

ratios on North-South traffic is not supported by substantial evidence, or any evidence at all, but it is directly contrary to the evidence.[38] The Northern railroads have not established and cannot establish, that their box car empty return ratios are any higher than those of the Southern railroads on North-South traffic. The whole claim here rests upon a statistical illusion, a classic example of the sort of thing to which Mr. Justice Brandeis was referring when he recognized that "averages are apt to be misleading." *United States* v. *Abilene & Southern R. Co.*, 265 U.S. 274, 291 (1924). It is also the kind of case to which Section 10(e) of the Administrative Procedure Act was directed in requiring that the courts set aside administrative orders not supported by substantial evidence.

F. The Commission's Resolution of the Issues With Respect to the Count of Cars Interchanged Was Unlawful.

The nature of the cost problem presented by the count of cars was summarized in the dissenting opinion of Com-

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[38] Refrigerator cars present essentially the same problem with respect to the empty return ratio cost factor as do the general purpose and assigned service box cars discussed above. Fresh meat moves in assigned refrigerator cars owned by the meat packing companies in much the same fashion as automobile parts move in assigned box cars. Because the proportion of fresh meat traffic is greater in the North than in the South (A. 851-852), these assigned refrigerators cars, like their box car counterparts, inflate the Northern railroads' average refrigerator car empty return ratios for a reason that has nothing to do with the North-South freight traffic at issue. Yet the Commission used territorial average refrigerator car empty return ratios without making any allowance at all for the impact upon these averages of such assigned cars.

missioner Murphy as follows (325 I.C.C. at 54-55; A. 86):

> "The improper counting of a car interchanged instead of terminated by the official lines affects the weighting of that car in computing switching costs. The official lines report a large volume of coal and ore terminated at port dumping facilities for loading onto boats as cars interchanged, while the southern lines report a large volume of phosphate rock hauled to ports for loading onto boats as cars terminated. These cars receive analogous services and should be treated as such. In both these instances the lading from the car is removed and the empty car is returned to the delivering carriers. The erroneous counting of cars terminated as cars interchanged on the official lines produces higher unit costs for official territory than for southern territory, both for origin and destination switching and for interchange switching."

No feature of this statement of the problem is questioned in the Commission's report. Instead, the Commission devotes its report to an attack upon the "estimate" used by the Southern railroads in an effort to correct the inconsistent counting of cars (325 I.C.C. 58-60; A. 91-94). The estimate in question was based upon certain reports made by the Northern railroads to the Commission (325 I.C.C. at 58; A. 92). The Northern railroads contended that "the information available is inadequate to correctly compute the adjustment" (325 I.C.C. 58; A. 92). The Commission accepted the "contentions" of the Northern railroads, and made no adjustment at all to correct the admitted inconsistency in the car count statistics underlying the average costs (325 I.C.C. 60; A. 94).

This was not a lawful disposition of the issue. Even assuming that the estimate made by the Southern railroads was inadequate, it was incumbent upon the Northern railroads to produce the data in their possession necessary to make an adjustment without resort to any estimate. Other-

wise, the Commission itself should have required the production of this data if, as it held, such data were necessary to a proper determination of the cost issues. Instead, the Commission permitted the Northern railroads to benefit from an inflation in their costs which was due in substantial part to a manifest inconsistency in the statistical count of cars, by accepting the Northern railroads' criticisms of the Southern railroads' effort to correct the statistics as a ground for making no adjustment at all. The Commission's action in granting an inflation to the Northern lines is not supported by substantial evidence where the inflation results from an admitted inconsistency in the count of cars interchanged.

G. The Commission's Treatment of the Constant Cost of Transit Commodities Was Unlawful.

This issue concerns the proper treatment of constant costs (including overhead costs of freight service) where the rates on raw materials are inseparably related to the rates on finished products. For example, pulpwood moves to paper plants within the South on rates which include little or no allowance for recovery of overhead costs (A. 881-882). The low rates on the inbound pulpwood are made at a very low level because they are related to the rates on finished paper products moving from the paper plants, including paper moving from the South to the North (A. 881).

When the Southern railroads urged an adjustment in the territorial average costs imputed to the North-South paper traffic to reflect the full costs of this traffic in the South, the Northern railroads again objected to the Southern railroads' position on the ground that a comparable adjustment would have to be made in the costs for the North (325 I.C.C. at 79-80; A. 126-127). But the Northern rail-

roads failed to come forward with any data showing that there is, in fact, a similar situation in the North. Indeed, the Northern railroads' own witness conceded that no such situation existed there (A. 1011). Yet the Commission upheld the Northern railroads' position and used average costs for both groups of railroads. On a record showing that no comparable situation existed in the North, the Commission's action was not supported by substantial evidence.[39]

III. THE COMMISSION HAS NOT LAWFULLY JUSTIFIED ITS ABANDONMENT OF UNIFORM DIVISIONS BETWEEN TERRITORIES HAVING UNIFORM RATES.

Beyond the question of the legal defects in the Commission's determination of relative cost of service and the unlawfulness of its treatment of particular cost issues, the

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[39] The Southern railroads' claim for inclusion of the deficits on pulpwood traffic as part of the cost of North-South traffic was based on the relationship between the rates on the inbound raw materials and the outbound movement of the finished products. *Pulpwood, North Carolina and Virginia to Cypress, Virginia*, 235 I.C.C. 11, 13 (1939). Assuming, however, that Commission counsel were correct in arguing that there is not a sufficient relationship between the inbound raw materials and the outbound traffic (ICC Brief, p. 47, n. 43), the fact remains that there is a pulpwood deficit borne by the Southern railroads (A. 881). If appellants were correct in their argument that commuter deficits, incurred wholly within the North and without any relationship to North-South traffic, "must be recovered from railroad freight operations if railroads are to remain solvent," as appellants argue (ICC Brief, p. 44; see also B&O Brief, p. 48), the same reasoning would apply to the deficits incurred by the Southern railroads on unrelated traffic. Appellants make no effort to reconcile their position on Northern commuter deficits with their position on the deficits borne by Southern railroads.

Commission committed a separate error in not justifying its abandonment of uniform divisions between the North and the South, particularly since those territories have uniform rate levels. On this issue, the district court pointed out (A. 351):

> "Furthermore, for many years prior to this case the Commission has consistently followed the view that the primary responsibility for meeting the cost and revenue needs of the railroads of any territory lies with the people and the industry of that territory. *New England Divisions,* 126 I.C.C. 579, 599 (1927); *Divisions of Rates, Official and Southern Territories,* 234 I.C.C. 175, 190 (1939); *Official-Southern Divisions,* 287 I.C.C. 497, 523 (1953); *Akron, Canton & Youngstown R. Co. v. Atchison, T. & S.F. Ry. Co.,* 321 I.C.C. 17, 51 (1963). In this very case, prior to re-opening, the Commission held that the primary division of revenues accruing from this traffic were to be made on an equal-factor scale. We recognize that the Commission is not perpetually bound by their 1953 holding, but we do believe that the Commission has special responsibilities in a case of this magnitude when it departs from its prior finding. (*Sec'y of Agriculture* v. *United States,* 347 U.S. 645)."

Appellants criticize this holding, suggesting: "[T]here is clearly nothing novel about one group of lines having proportionately higher divisions than the other on North-South traffic" (B&O Brief, pp. 61-62, n. 30), and pointing out that the Commission has power to change any of its decisions (ICC Brief, p. 54, n. 48). However, the district court expressly recognized the Commission's power to change its policies and decisions, holding only that when such a change is made, the Commission must explain the reasons for its action. This principle is plainly sound and fully supported by the decision of this Court in *Secretary of Agriculture* v. *United States,* 347 U.S. 645, 652-654 (1954), cited by the district court.

Appellants do not and cannot deny that in prescribing divisions on North-South traffic the Commission has regularly followed its policy of placing the primary responsibility for meeting the cost and revenue needs of any territory upon the people and industry of that territory. In 1939, the first time that the Commission prescribed a general basis of divisions on North-South traffic, the Commission ordered an inflation in the divisions of the Southern railroads on the express ground that the rates in the South were higher than the rates in the North. *Divisions of Rates, Official and Southern Territories,* 234 I.C.C. 175, 190 (1939):

> "In view of the factors which have been responsible for the measure of these rates, therefore, there is logic in the argument of the southern lines that 'the rates which contain something above the official level, because of the southern lines' participation, should be divided so as to give the increment in the rate to the southern carriers.'"

On that portion of the North-South traffic as to which the rate level in the South was not on a substantially higher level than in the North, no inflation was prescribed (234 I.C.C. at 191, 192-193):

> "In our view the existence of the increment or excess in the interterritorial rates may and should be taken into account by allowing the southern lines divisional factors on general traffic higher than those of the northern lines by a uniform percentage.
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> . . . Where no such increment is to be found in the rates . . . fair application of the principal demands that the divisions of each group of carriers be on the same basis."

Thereafter, the Commission found that the higher rate level in the South discriminated against the South and

prescribed a uniform level of class rates. *Class Rates Investigation, 1939,* 262 I.C.C. 447 (1945); 281 I.C.C. 213 (1951). The Commission's action was upheld by this Court in *New York* v. *United States,* 331 U.S. 284 (1947). In 1953, in recognition of its previous action in prescribing a uniform rate level, the Commission prescribed divisions on a uniform basis with no inflation for either Northern or Southern railroads. *Official-Southern Divisions,* 287 I.C.C. 497, 523 (1953). The same action was taken in *Official-Southwestern Divisions,* 287 I.C.C. 553, 580 (1953).

Measured against this long-established relationship between divisions and the relative rate levels in the two territories, what reason or basis does the Commission now advance for changing its method of determining the propriety of an inflation? There has been no change in the uniformity of the class rates prescribed by the Commission and upheld by this Court. And there was no showing by the Northern railroads that there is any higher rate level in the North which would justify an inflation in the Northern divisions under the Commission's long-established standard.

In citing past North-South divisions cases in which divisions inflations were prescribed (B&O Brief, pp. 61-62, n. 30), appellants disregard the critical fact that in those cases, differences in divisions were justified by different rate levels. If the alleged higher costs in the North were actually reflected in higher rates in the North than in the South, the situation would be very different. Under such a hypothesis, the Southern railroads and the Southern economy would have a competitive advantage over shippers in the North, an advantage which would offset the payment of inflated divisions reflecting the higher rate level in the North. This situation was just the reverse when the Southern railroads received inflated divisions due to a higher rate level in the South.

Now, however, the rates are uniform in the North and South. They were made uniform for the express purpose of relieving the Southern economy of the disadvantage of a higher rate level. *New York* v. *United States*, 331 U.S. 284 (1947). The Northern railroads do not suggest that they are willing to subject the North to the disadvantages of a higher rate level. The Northern railroads want it both ways. They would keep the rate structure uniform so that Northern shippers can compete with Southern shippers on an equal basis, but they would nevertheless impose upon the Southern railroads the burden of subsidizing the allegedly higher Northern costs. This puts the cart before the horse. Unless and until the Commission prescribes higher rates for the North, higher *territorial average* costs may not be used to take money from the Southern railroads and the economy which they serve. The Commission itself did not purport to base its order on costs representing the territorial average costs, but upon the costs of North-South traffic (p. 4, *supra*).

Nothing in Section 15(6) of the Interstate Commerce Act authorizes the Commission to regard divisions based upon relative costs as so obviously just, reasonable, and equitable, that their prescription follows as a matter of course and without the reasoned findings to explain such action as required by the Administrative Procedure Act. It is important to recognize that cost-oriented divisions, even if based upon the costs incurred in handling the traffic at issue, have an effect far beyond merely returning higher costs to the railroads which incurred them. Such a cost basis of divisions also divides the profits realized on the traffic involved in accordance with cost proportions, which means that the railroads with higher costs for performing the same services not only recover those costs, but also receive a greater share of the profits by virtue of

the existence of such higher costs. Thus, in this case, the Northern railroads are given an inflated share of approximately $140 million in profits realized in excess of all of the costs incurred by all of the railroads participating in the movement of North-South freight traffic, even under the cost findings of the Commission.[40]

On the face of the matter, the division of profits realized from the movement of freight traffic would seem to turn more upon considerations of revenue need than costs. Indeed, in *Akron, Canton & Youngstown R. Co.* v. *Atchison, T. & S.F. Ry. Co.*, 321 I.C.C. 17, 51 (1963), the Commission itself took the position that constant costs, as well as profits, "are significant in the consideration of revenue need." Under this approach, the revenues in excess of out-of-pocket costs would have been divided on the basis of revenue needs rather than cost considerations.

The arguments advanced by the appellants in this Court greatly strengthen this conclusion. For appellants attack the judgment of the district court requiring the Commission to determine the actual costs of North-South traffic in large part upon the ground that it is impossible to determine the actual costs of this traffic (ICC Brief, pp. 26-27; B&O Brief, pp. 33-34). The Commission has not itself suggested that no greater precision than unadjusted territorial averages is possible in costing a body of traffic. But if appellants were correct that it is impossible to determine the costs of North-South traffic with any precision, what then is the justification for the inflation accorded the Northern rail-

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[40] From the Commission report (325 I.C.C. at 25-26; A. 48-49), it can be calculated that total revenues on this traffic amount to $496,086,000 ($221,430,000 plus $274,656,000), while total costs as found by the Commission amount to $357,572,000 ($165,746,000 plus $191,826,000), from which figures the profit on the traffic appears as $138,514,000.

roads? This argument reduces this entire proceeding to a shell game. The Northern railroads ask for and receive an inflation in their divisions to offset allegedly higher costs of handling North-South traffic. But when the district court sets aside that order because the claim of higher Northern costs is not supported by evidence of the specific higher costs claimed, that judgment is criticized on the ground that it is impossible to determine specific costs. If the Commission cannot determine with reasonable reliability that the Northern railroads have higher costs on North-South traffic, there is no basis for abandoning the policy of uniformity in divisions of revenues.

Moreover, the Northern railroads would have no just claim to recover higher costs incurred, even if such costs had properly been shown to be related to the traffic at issue, where these higher costs are the product of such factors as those claimed and found by the Commission to exist in this case. The higher Northern costs found and relied upon by the Commission in this case are not based upon any showing of inherently more difficult transportation conditions in the North. Instead, the Northern railroads' cost inflation is based wholly upon higher costs claimed to have been incurred on the specific items previously discussed (pp. 30-68, *supra*). Thus, even if the Commission's cost findings are accepted as establishing everything which they purport to establish, we are left with nothing more than findings such as: that the cost of interchanging cars is higher for the Northern railroads than for the Southern railroads, even where interchange occurs at jointly owned freight yards; that the Northern railroads have substantially higher car costs on traffic that moves in the same cars in both territories; that it costs the Northern railroads more to switch the same cars than it does the Southern railroads; and so on.

It is simply not correct, at least in the absence of specific justification by the Commission, that higher costs based upon these sorts of factors should be recoverable in the form of an inflation in divisional factors, even if such costs were shown to be applicable to the particular traffic involved. The very first standard toward which the Commission's attention is directed by Section 15(6) is that of relative efficiency. Although the Commission here concluded in ultimate terms that the two groups of carriers are equally efficient (325 I.C.C. at 16-18; A. 37-39), it never explained, or even attempted to explain, how this ultimate statutory conclusion could be squared with its cost findings. In the absence of any justification, the Commission's specific cost findings impeach the conclusion of equal efficiency.

The only discussion of any of these problems in the Commission's report appears in connection with the rejection of the position of the Southern Governors Conference and Southeastern Association of Railroad and Utilities Commissioners (325 I.C.C. at 26-28; A. 50-51). That portion of the report falls far short of containing any rational explanation that would enable anyone to understand why uniformity of rate levels is regarded as immaterial in this case although the same factor has been regarded as controlling by the same Commission administering the same statute for a generation.

As the district court pointed out, the Commission is not perpetually bound by prineiples it has previously followed in prescribing divisions between the North and the South, but it does have a statutory duty to articulate a policy which justifies any such major and radical change as is involved here.

IV. THE DISTRICT COURT WAS CORRECT IN SETTING ASIDE THE COMMISSION'S ORDERS WITHOUT RESERVING JURISDICTION.

The Northern railroads also argue that the district court erred in failing to reserve jurisdiction so as to permit a retroactive "application of such divisions as the Commission might ultimately prescribe to all traffic moving subsequent to April 20, 1965" (B&O Brief, p. 57). Commission counsel made no such request and the Northern railroads themselves never asked the court below to reserve jurisdiction. To the contrary, the Northern railroads expressly agreed in the court below to re-settle all revenues accruing during this litigation in accordance with the pre-existing basis of divisions, in the event the Commission's orders were set aside. Thus, the order of the district court denying an interlocutory injunction states (A. 170):

> "In the event the plaintiffs are successful in permanently setting aside the order of the Interstate Commerce Commission of February 3, 1965, intervening defendants, The Baltimore & Ohio Railroad Company et al., will resettle their accounts with plaintiffs, on traffic covered by the order of the Commission, on the basis of the present divisions, on all shipments made on and after April 20, 1965, with interest at the rate of 5% per annum on the monthly differences between revenues based upon the divisions prescribed by the Commission and revenues based upon the divisions now in effect, the said interest to be calculated from the customary accounting monthly settlement dates."

This order expressly recites that these are conditions "to which the intervening defendants, The Baltimore and Ohio Railroad Company et al., have agreed by filing written consent with the Clerk of this Court" (A. 169). There can be no justification for permitting the Northern railroads to renege on an explicit undertaking.

The refund obligation to which the Northern railroads subjected themselves relates to nothing more than the inflation in their divisions which was unlawfully prescribed. Clearly, the Northern railroads are not entitled to an inflation where they have not supported such a claim with evidence.

There is nothing unfair to the Northern railroads in such a procedure. It leaves those railroads in the precise position in which they affirmatively placed themselves when they successfully resisted an interlocutory injunction by their specific agreement to refund revenues they never would have received if an interlocutory injunction had issued. Moreover, it leaves the Northern railroads in precisely the same situation with respect to their claim for an inflation as that in which the Southern railroads find themselves with respect to their claim that the structure of the pre-existing equal-factor divisions unfairly favors the Northern railroads.

Throughout the proceedings before the Commission, the Southern railroads contended that the equal-factor basis of divisions then in effect contained a terminal allowance which was excessive to the extent of 37 factors (A. 829-830). Because the Northern railroads are predominately short-haul carriers on North-South traffic, this excessive terminal allowance accords the Northern railroads some $7,426,000 a year more revenue from North-South traffic than those railroads would be entitled to under a properly constructed equal-factor scale (A. 329).

The nature of this unfairness in scale construction may be illustrated by a comparison of the previously existing divisional scale (287 I.C.C. at 552, col. 1), with the equal-factor scale which the Southern railroads showed to be properly constructed in the proceedings before the Commission (287 I.C.C. 552, col. 1; A. 829-830):

Miles	Pre-existing Uniform Divisional Scale		Same Scale Corrected to Deduct 37 Factors	
	North	South	North	South
50	65	65	28	28
100	77	77	40	40
150	89	89	52	52
200	101	101	64	64
250	113	113	76	76
300	125	125	88	88
350	137	137	100	100
400	149	149	112	112
450	161	161	124	124
500	174	174	137	137
550	186	186	149	149
600	198	198	161	161
650	210	210	173	173
700	222	222	185	185
750	234	234	197	197
800	246	246	209	209
850	258	258	221	221
900	270	270	233	233
950	282	282	245	245
1000	294	294	257	257

Under either of these scales, if the hauls in the North and South are the same (300 miles in each territory, for example) each territory would receive 50 percent of the revenue. But if the hauls are different, then the difference in the construction of the scales has a substantial effect on the shares of the revenues. For a 50-mile haul in the North and a 1000-mile haul in the South, the existing uniform divisional scale would produce a division of 18 percent for the 50-mile haul in the North. Using the corrected scale, the division for the 50-mile haul in the North becomes 10 percent. This is a difference of 8 percentage points, or $8 out of every

$100 of revenue, and this difference in the revenues occurs even though both scales are uniform scales for both North and South with no inflation for either territory.

In its report, the Commission agreed with the Southern railroads' contentions with respect to the improper construction of the pre-existing equal-factor scale (325 I.C.C. at 37; A. 63):

> "The new evidence adduced upon further hearing demonstrates that the foregoing contentions of the southern lines have merit, and we so find."

Accordingly, the new scales prescribed by the Commission, although even more favorable to the Northern lines by reason of the inflation in their factors, do not contain the excessive terminal allowances which were present in the pre-existing equal-factor scales.

In the district court the Southern railroads took the position that in setting aside the inflation prescribed for the Northern railroads, the court need not disturb the Commission's action in correcting the terminal allowance in the scales, because, in our view, that latter aspect of the order was severable. The Northern railroads strongly opposed this contention and succeeded in convincing the district court that if the order were to be set aside, it must be set aside in its entirety (A. 330).

Under these circumstances, the effect of the judgment below is to set aside the Commission's order and leave the Northern railroads with an equal-factor basis of divisions that benefits the Northern railroads at the rate of $7,426,000 per year because of a distortion in the construction of the equal factor scales already found to be unlawful by the Commission on the basis of the evidence. The Southern railroads will have every bit as much incentive to expedite a decision of the Commission to correct a defect in the

divisional scales which they have already proved as the Northern railroads will have in attempting to obtain an inflation which they have not proved. Since there is nothing about this situation that is inequitable to the Northern railroads, there is no reason for this Court to disturb the form of judgment to which the Northern railroads agreed in the district court.

Nor, in a case in which the Commission's order has been held to be unlawful, is there anything inequitable about remanding the case to the Commission simply because the proceedings began some years before. The Northern railroads suggest that because of the lapse of time since this case was started before the Commission, this Court should sustain an otherwise unlawful order (B&O Brief, pp. 20, 30, 56). The Court has never sanctioned the notion that lapse of time justifies denying an aggrieved party effective judicial review.[41] And it would be grossly inequitable to burden the Southern railroads with reduced divisions where the Northern railroads, despite full opportunity to prove their case, failed to produce evidence to support any Northern inflation on North-South traffic.

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[41] The cases relied upon by the Northern railroads are inapposite. In three of the cases, the question was whether judicial review of a particular issue should be granted in this Court or in a lower federal court, not whether effective judicial review should be denied altogether. *Consolo* v. *Federal Maritime Commission*, 383 U.S. 607, 621 (1966); *Chicago & N.W. R. Co.* v. *Atchison, T. & S. F. Ry. Co.*, 387 U.S. 326, 356 (1967); *Permian Basin Area Rate Cases*, 390 U.S. 747, 823-824 (1968). In the remaining case cited, *Illinois Central R. Co.* v. *Norfolk & Western R. Co.*, 385 U.S. 57, 75 (1966), the question was whether, upon holding that the Commission order was valid on the record as made, the Court should nevertheless remand the case to the Commission to take evidence of "present conditions." No such question is involved in this case, in which the district court has remanded the case to the Commission because it found that the order was not lawfully supported by the record (A. 354).

The duration of the most recent phase of the controversy, beginning with the Northern railroads' petition for an inflation in 1956, is chargeable to the Northern railroads and the Commission, not the Southern railroads.[42] Realistically, the struggle between the Northern and Southern railroads over divisions of freight rates was carried on for generations prior to this most recent phase. It was resolved in 1953, consistent with the landmark decision ordering uniformity of rates in *New York* v. *United States*, 331 U.S. 284 (1947), by the prescription of a uniform and equal basis of divisions. The Commission has not entered a lawful order, supported by evidence, changing those uniform divisions, and there is no reason to assume that the Commission will abandon equal divisions when the case is reconsidered on remand.

CONCLUSION

The district court has properly applied the standards of the Administrative Procedure Act in reviewing the Commission's order in this case. It has emphasized—not undermined—the Commission's responsibilities. The district

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[42] Although the Northern railroads filed their petition for inflated divisions in November of 1956 (A. 373), they did not present their first witness until November of 1959 (A. 415). The Southern railroads completed the presentation of their evidence in July of 1960. The record was closed in February of 1961, but the Examiners' report was not served until July of 1963, and the Commission's report and order were not served until March of 1965.

Contrary to the contentions of the Northern railroads (B&O Brief, pp. 16-17), the district court did not hold that the Commission must make new traffic and cost studies. While observing that evidence was becoming more and more vulnerable to the charge of staleness, the district court specifically stated that this observation did not "indicate that it would necessarily be an abuse of discretion for the Commission not to re-open the investigation to receive later operating figures . . ." (A. 356).

court, in remanding the cause to the Commission, has not restricted the Commission in its use of Rail Form A costs or any other factor so long as their application under the standard adopted by the Commission is supported by evidence: No new limits or standards have been imposed on the Commission's discretion. There is only the requirement that its orders be based upon findings which are supported by evidence.

This case has been remanded to the Commission for further proceedings consistent with requirements of the Administrative Procedure Act. The United States, which is charged by statute with the responsibility for defending orders of the Commission, has not appealed this disposition of the case.

Accordingly, the judgment of the district court should be affirmed.

Respectfully submitted,

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